

Substantive consolidation often has many significant benefits, including enhancing the likelihood of confirmation of Chapter 11 plans of reorganization, advancing the equitable interest in fair distribution of assets when there has not been actual prior reliance on the corporate separateness of affiliated companies, and avoiding the delay and often insuperable difficulties associated with trying to unwind transactions between related corporations.

The appropriate use of substantive consolidation is a central and recurring issue in large corporate bankruptcies. Substantive consolidation has played a critical role in the reorganization of seven of the ten largest Chapter 11 bankruptcy cases since 2000, including *Enron*,<sup>2</sup> and *WorldCom*.<sup>3</sup> See William H. Widen, *Prevalence of Substantive Consolidation in Large Bankruptcies from 2000 to 2004: Preliminary Results* 9 (Dec. 23, 2005) ("Widen") (unpublished manuscript, available at <http://uccstuff.com/Prevalence-of-Substantive-Consolidation.pdf>). Altogether, more than 100 reported bankruptcy decisions involve whether to substantively consolidate related corporate entities. Moreover, the practical importance of this issue is demonstrated by the value that turns on it in this case alone, where without substantive consolidation more than \$1 billion would go to one unsecured creditor constituency at the expense of all others even though the District Court found as a matter of fact that that creditor constituency did not rely upon the separate identities of different corporate entities. See Pet. App. 35a.

Despite the significance and recurrence of this issue, the courts of appeals have not adopted a single, readily applicable standard that ensures that creditors will be treated

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<sup>2</sup> See Order Confirming Supplemental Modified Fifth Amended Joint Plan of Affiliated Debtors Pursuant to Chapter 11 of the United States Bankruptcy Code, and Related Relief, *In re Enron Corp.*, Case No. 01-16034, Docket No. 19759 (Bankr. S.D.N.Y. July 15, 2004).

<sup>3</sup> See Order Confirming Debtors' Modified Second Amended Joint Plan of Reorganization Under Chapter 11 of the Bankruptcy Code, *In re WorldCom, Inc.*, Case No. 02-13533, Docket No. 9686 (Bankr. S.D.N.Y. Oct. 31, 2003).

uniformly no matter in which circuit a debtor files for bankruptcy – and, equally important, that would allow creditors to structure transactions in advance to account for a clear rule on this important issue. On the contrary, by the Third Circuit’s own account, ten circuits (including itself) have considered the substantive-consolidation remedy. The circuits deciding whether and when to apply this remedy have used at least three substantively conflicting analyses, including the wholly new mode devised by the court of appeals in this case. *See id.* at 15a (explaining that prior circuit court opinions “slipstreamed” behind two competing standards, both of which the Third Circuit ultimately rejected in favor of its own conflicting standard); *see also In re Bonham*, 229 F.3d 750, 765 (9th Cir. 2000) (“No uniform guideline for determining when to order substantive consolidation has emerged.”); 2 *Collier on Bankruptcy* § 105.09[2], at 105-89 (15th ed. 1996) (“The courts have not . . . developed a clear legal standard governing when the [substantive-consolidation] doctrine is to be applied.”).

Certiorari is particularly warranted here because the Third Circuit’s decision, in contrast to the holdings of other courts of appeals, effectively eliminates a bankruptcy court’s power to do equity through the use of substantive consolidation. As a practical matter, the Third Circuit’s holding precludes the possibility of substantive consolidation over the objection of any creditor that can claim to be harmed, even where there is overwhelming evidence of substantial identity among the entities to be consolidated and there are enormous benefits to be obtained by using substantive consolidation. In this regard, the conflict between the Third Circuit’s holding and the holdings of other courts is stark. The D.C., Second, Sixth, Eighth, and Eleventh Circuits all expressly permit consideration of overall costs and benefits in considering whether to grant substantive consolidation, and other courts, including the Ninth Circuit, have permitted substantive consolidation on facts like those at issue here. Moreover, the Third Circuit established an explicit bar on what it termed a “deemed consolidation” (in which consolidation is effected solely for bankruptcy proceedings), even though other courts have

approved restructurings involving the use of deemed consolidations. For these and other reasons discussed below, this case would have come out differently if decided under the law of other courts of appeals.

### **OPINIONS BELOW**

The Third Circuit's opinion (Pet. App. 1a-30a) is reported at 419 F.3d 195. The District Court's opinion (Pet. App. 31a-37a), granting substantive consolidation in this case, is reported at 316 B.R. 168.

### **JURISDICTION**

The judgment of the Third Circuit was entered on August 15, 2005. A petition for rehearing was denied on September 28, 2005. *See* Pet. App. 38a. On December 20, 2005, Justice Souter extended the time within which to file a petition for a writ of certiorari to and including January 26, 2006. *See id.* at 44a. This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1).

### **STATUTES INVOLVED**

The relevant statutory provisions are 11 U.S.C. §§ 105(a) and 1123(a)(5)(C). Section 105(a) provides:

(a) The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title. No provision of this title providing for the raising of an issue by a party in interest shall be construed to preclude the court from, sua sponte, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process.

Section 1123(a)(5)(C) provides:

Notwithstanding any otherwise applicable nonbankruptcy law, a plan shall . . . (5) provide adequate means for the plan's implementation, such as . . . (C) merger or consolidation of the debtor with one or more persons[.]

The full text of sections 105 and 1123 are reproduced at Pet. App. 39a-43a.

## **STATEMENT OF THE CASE**

The Official Representatives seek review of the judgment of the Third Circuit, which reversed the decision of the United States District Court for the District of Delaware (Fullam, Sr. J.) ordering substantive consolidation in this case.

### **A. The Bankruptcy Proceeding**

On October 5, 2000, the Debtors filed separate voluntary petitions for relief in the United States Bankruptcy Court for the District of Delaware under Chapter 11 of Title 11 of the United States Code, 11 U.S.C. §§ 101-1330 (as amended, the "Bankruptcy Code"). The Debtors continue to manage and operate their business as debtors and debtors-in-possession pursuant to sections 1107 and 1108 of the Bankruptcy Code.

On October 23, 2000, the United States Trustee appointed the Official Committee of Unsecured Creditors (the "Creditors Committee") and the Official Committee of Asbestos Claimants (the "Asbestos Committee"). Subsequently, by order dated September 28, 2001, the Bankruptcy Court appointed James J. McMonagle, Esquire, as the Legal Representative for Future Claimants (the "Futures Representative"),<sup>4</sup> and on July 16, 2001, the Bankruptcy Court issued an order authorizing and approving the employment and retention of Anderson Kill & Olick, P.C., *nunc pro tunc*, from March 26, 2001, as special counsel to the bondholder and trade creditor constituencies, to the extent that their interests diverge from those of the Creditors Committee as a whole. It is these bondholders and trade creditors that, by their Official Representatives, bring this Petition.

### **B. The District Court Decision**

On January 17, 2003, the Debtors, along with the Asbestos Committee and the Futures Representative (collectively, the "Plan Proponents"), proposed a plan of reorganization (the "Plan") that provided for the substantive consolidation of the

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<sup>4</sup> On December 23, 2005, the Futures Representative filed his petition for a writ of certiorari (No. 05-827) also seeking review of the Third Circuit's decision. Official Representatives incorporate and adopt herein the arguments made by the Futures Representative.

estates of the Debtors and certain of their non-debtor affiliates. In connection with the Plan, the Plan Proponents filed a motion seeking approval of the substantive consolidation provision of the Plan (the "Substantive Consolidation Motion") (Docket No. 6758); it was supported by the Official Representatives and was opposed only by a group of banks (the "Banks") that had obtained loan guarantees from certain OCD subsidiaries (the "Subsidiary Guarantors"). The Banks asserted that the subsidiary guarantees gave them direct claims against the Subsidiary Guarantors, independent of their claims against OCD, thus placing them in a "structurally senior" position to other unsecured creditors of OCD. Under the Banks' theory, they would receive payment in full on their claims, while all other OCD unsecured creditor constituencies would receive substantially less. As proposed, the Plan, which was contingent on substantive consolidation, would have eliminated all intercompany liabilities, including the subsidiary guarantees held by the Banks, and would have resulted in a *pro rata* distribution of assets to Owens Corning's unsecured creditor constituencies.

The 13-day hearing on the Substantive Consolidation Motion began on April 8, 2003, and was presided over by District Judge Alfred M. Wolin. In May 2004, after Judge Wolin was recused from the Debtors' bankruptcy proceedings, *see In re Kensington Int'l Ltd.*, 368 F.3d 289, 293 (3d Cir. 2004), the Substantive Consolidation Motion was reassigned to Senior Judge John P. Fullam, who ordered further briefing and argument on the issue. In a Memorandum and Order dated October 5, 2004, Judge Fullam, applying the D.C. Circuit's substantive-consolidation standard as enunciated in *In re Auto-Train Corp.*, 810 F.2d 270 (D.C. Cir. 1987) (Williams, J.), granted the Substantive Consolidation Motion. The District Court made the following critical factual findings in deciding that substantive consolidation was appropriate in this case:

- All of the subsidiaries were controlled by a single committee, from central headquarters, without

regard to the subsidiary's operational or legal structure;

- Control was exercised on a product-line basis and not based on separate corporate distinctions;
- The officers and directors of the subsidiaries did not establish business plans or budgets, and did not appoint senior management except at the direction of the central committee;
- Subsidiaries were established for the convenience of the parent company, primarily for tax reasons;
- The financial management of the entire enterprise was conducted in an integrated manner;
- It would be exceedingly difficult to untangle the financial affairs of the various entities;
- The Banks relied upon the creditworthiness of the entire Owens Corning enterprise, not that of each of the Subsidiary Guarantors;
- All of Owens Corning's financial reporting was done on a consolidated basis, and only that consolidated information was provided to the Banks;
- In seeking and obtaining guarantees from the Subsidiary Guarantors, the Banks had no information about the debts of such subsidiaries; and
- There was "simply no basis" for a finding that, in extending credit, the Banks relied upon the separate credit of any of the Subsidiary Guarantors.

*See* Pet. App. 34a-35a. The District Court concluded that substantive consolidation was appropriate in this case because (i) there was "indeed substantial identity between the parent debtor OCD and its wholly-owned subsidiaries"; and (ii) "the Banks relied upon the overall credit of the entire Owens Corning enterprise." *Id.* at 34a, 35a.

### **C. The Third Circuit Decision**

By order dated August 15, 2005, the Third Circuit reversed the District Court's decision and found that the District Court improperly granted the motion for substantive consolidation.

In so doing, the Third Circuit propounded a new standard for substantive consolidation, which requires a proponent of substantive consolidation to prove that: "(i) prepetition [the debtors and their affiliates] disregarded separateness so significantly their creditors relied on the breakdown of entity borders and treated them as one legal entity, or (ii) postpetition their assets and liabilities are so scrambled that separating them is prohibitive and hurts all creditors." Pet. App. 22a (footnote omitted). To establish a *prima facie* case under the first rationale of the Third Circuit's new standard,

[p]roponents who are creditors must also show that, in their prepetition course of dealing, they actually and reasonably relied on debtors' supposed unity. Creditor opponents of consolidation can nonetheless defeat a *prima facie* showing . . . if they can prove they are adversely affected and actually relied on debtors' separate existence.

*Id.* at 23a (citation omitted).

Notably, the Third Circuit also rejected outright two established aspects of substantive consolidation. First, the Third Circuit eliminated the use of "deemed" consolidations (*i.e.*, consolidations that do not effectuate an actual merger of the related companies under applicable state corporate law but deem them consolidated for the limited purpose of voting on, and determining distributions under, a plan of reorganization). Second, the court of appeals prohibited the use of substantive consolidation to alter contractual rights and thus change the relative positions of the various groups of creditors in the plan negotiation process. *See id.* at 22a, 29a.

## REASONS FOR GRANTING THE PETITION

### **I. A CLEAR CONFLICT AMONG THE CIRCUITS EXISTS CONCERNING THE STANDARD FOR, AND APPROPRIATE USE OF, SUBSTANTIVE CONSOLIDATION**

#### **A. The Third Circuit's Analysis Differs Materially From The Already-Conflicting Standards Of Other Circuit Courts**

The ability to order substantive consolidation "has been considered part of the bankruptcy court's general equitable powers since the passage of the Bankruptcy Act of 1898." *Bonham*, 229 F.3d at 763 (citing *Sampsell v. Imperial Paper & Color Corp.*, 313 U.S. 215, 219 (1941)). "The power of the bankruptcy court to subordinate claims or to adjudicate equities arising out of the relationship between the several creditors is complete." *Sampsell*, 313 U.S. at 219 (citing *Taylor v. Standard Gas & Elec. Co.*, 306 U.S. 307 (1939); *Pepper v. Litton*, 308 U.S. 295 (1939)).

Despite the bankruptcy courts' century-old power to order substantive consolidation, the circuit courts are mired in conflict over the appropriate mode of analysis to determine when such power may be applied. Indeed, even before the Third Circuit issued the opinion at issue here, there was a clear split of authority in the circuits. As the Third Circuit itself acknowledged in discussing prior decisions, "[u]ltimately most courts [interpreting the law of substantive consolidation have] slipstreamed behind two rationales – those of the Second Circuit in [*In re Augie/Restivo Baking Co.*, 860 F.2d 515 (2d Cir. 1988),] and the D.C. Circuit in *Auto-Train*." Pet. App. 15a. The *Augie/Restivo* and *Auto-Train* standards differ in significant, often case-dispositive respects.

Under the *Auto-Train* standard employed in the D.C., Eighth, and Eleventh Circuits, a party seeking to substantively consolidate debtors' estates must demonstrate that: (i) there is substantial identity between or among the entities to

be consolidated;<sup>5</sup> and (ii) consolidation is necessary to avoid some harm or to realize some benefit. See *Auto-Train*, 810 F.2d at 276; *Eastgroup*, 935 F.2d at 249; *In re Giller*, 962 F.2d 796, 799 (8th Cir. 1992) ("Factors to consider when deciding whether substantive consolidation is appropriate include 1) the necessity of consolidation due to the interrelationship among the debtors; 2) whether the benefits of consolidation outweigh the harm to creditors; and 3) prejudice resulting from not consolidating the debtors."). Once the proponent of substantive consolidation has made the initial showing of substantial identity, a presumption arises that creditors did not rely on the individual creditworthiness of any of the entities to be consolidated and the burden of proof shifts to an objecting creditor to show that it actually "relied on the separate credit of one of the entities [being consolidated] and that it will be prejudiced by the consolidation." *Auto-Train*, 810 F.2d at 276; see *Eastgroup*, 935 F.2d at 249. In these circuits, even if the objecting creditor does demonstrate such actual reliance, the court may nevertheless grant substantive consolidation if "it determines that the demonstrated benefits of consolidation 'heavily' outweigh the harm.'" *Eastgroup*, 935 F.2d at 249 (quoting *Auto-Train*, 810 F.2d at 276); see also *In re Baker & Getty Int'l Servs., Inc.*, 974 F.2d 712, 720 (6th Cir. 1992) (Sixth Circuit likewise emphasizes need to weigh benefits and burdens and approves substantive consolidation where "practical necessity of consolidation to protect the possible realization of any recovery for the majority of the unsecured creditors far

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<sup>5</sup> When assessing the "substantial identity" prong of the *Auto-Train* test, courts have identified a non-determinative list of factors that a court should consider, including: "(1) The presence or absence of consolidated financial statements. (2) The unity of interests and ownership between various corporate entities. (3) The existence of parent and intercorporate guarantees on loans. (4) The degree of difficulty in segregating and ascertaining individual assets and liabilities. (5) The existence of transfers of assets without formal observance of corporate formalities. (6) The commingling of assets and business functions. (7) The profitability of consolidation at a single physical location." *Eastgroup Props. v. Southern Motel Ass'n*, 935 F.2d 245, 249 (11th Cir. 1991).

outweighs the prospective harm to any particular creditor") (internal quotation marks omitted).

The Second and Ninth Circuits follow the meaningfully different standard for substantive consolidation established in *Augie/Restivo*. See *Bonham*, 229 F.3d at 766 (adopting the Second Circuit's "independent" test as "more grounded" in "economic theory"). Under *Augie/Restivo*, the proponent must demonstrate that substantive consolidation is appropriate by showing either that (i) creditors dealt with the entities to be consolidated as a single economic unit and did not rely on their separate identity in extending credit, or (ii) the affairs of the debtors are so entangled that consolidation will benefit all creditors. See 860 F.2d at 518.

One key substantive difference between these approaches is that the *Auto-Train* line of cases authorizes a balancing of costs and benefits and permits consolidation where that is beneficial on the whole even if it harms a specific creditor or creditors. See, e.g., *In re Permian Producers Drilling, Inc.*, 263 B.R. 510, 518 (W.D. Tex. 2000); Robert D. Ellis, *Securitization Vehicles, Fiduciary Duties, and Bondholders' Rights*, 24 J. Corp. L. 295, 306 n.61 (1999). Under *Augie/Restivo*, no such balancing is permitted; instead, the focus is on protection of contractual expectations of creditors. See, e.g., Mary Elisabeth Kors, *Altered Egos: Deciphering Substantive Consolidation*, 59 U. Pitt. L. Rev. 381, 408 (1998).

In this case, the Third Circuit further fragmented the courts of appeals' holdings on this issue by adopting yet another mode of analysis – one that is based on the express repudiation of the *Auto-Train* approach and that is significantly more restrictive than *Augie/Restivo* in practically important ways. The Third Circuit made exceedingly plain that it "disagree[d]" with the *Auto-Train* approach because, among other things, it permitted a balancing of costs and benefits:

The *Auto-Train* approach . . . adopts, we presume, one of the *Augie/Restivo* touchstones for substantive consolidation while adding the low bar of avoiding some harm or discerning some benefit by consolidation. To us this fails to capture completely the few times

substantive consolidation may be considered and then, when it does hit one chord, it allows a threshold not sufficiently egregious and too imprecise for easy measure. For example, we disagree that "[i]f a creditor makes [a showing of reliance on separateness], the court may order consolidation . . . if it determines that the demonstrated benefits of consolidation 'heavily' outweigh the harm."

Pet. App. 19a. The Third Circuit's analysis also differs in substantively significant ways from the *Augie/Restivo* line of cases in the Second and Ninth Circuits. For instance, those courts require only that creditors "dealt with" the affiliated entities as a single unit, but the Third Circuit requires affirmative proof that the affiliated corporations "disregarded separateness so significantly their creditors relied on the breakdown of entity borders and treated them as one legal entity." *Id.* at 22a.<sup>6</sup>

Beyond that, the Third Circuit parted company with the Sixth Circuit and several lower courts in creating a blanket rule prohibiting the use of "deemed" substantive consolidations. *Id.* at 29a ("Such 'deemed' schemes we deem not Hoyle."); see pp. 17-20, *infra*.

## **B. The Circuit Split Leads To Disparate Results In Different Courts**

The distinctions between the analysis employed by the Third Circuit here and by other courts of appeals in prior

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<sup>6</sup> The Third Circuit's decision also alters the parties' respective burdens of proof. Under the *Auto-Train* standard, once the proponent of substantive consolidation demonstrates "substantial identity" between the entities to be consolidated, a presumption arises that creditors did not rely on the individual creditworthiness of any of the entities being consolidated. See *Eastgroup*, 935 F.2d at 249. In the Third Circuit, however, the creditor proponents, who have already established the entities' significant disregard of separateness, also are saddled with the additional requirement of proving that, "in their prepetition course of dealing, [creditor proponents] actually and reasonably relied on debtors' supposed unity." Pet. App. 23a. The effect is to place the entire burden of proof on the proponent of substantive consolidation.

cases are not mere matters of verbiage. Rather, there are real differences in analysis here that lead to disparate results depending on where a debtor files for bankruptcy. This is true in multiple respects.

First, the Third Circuit concluded that the existence of separate guarantees from affiliates of OCD creates a *per se* bar on substantive consolidation. See Pet. App. 24a. In the Third Circuit's terms, it rejected substantive consolidation in all situations where creditors "lawfully bargained prepetition for unequal treatment by obtaining guarantees of separate entities." *Id.* at 29a-30a. This restriction is diametrically opposed to the decisions of other circuit courts. See, e.g., *Soviero v. Franklin Nat'l Bank*, 328 F.2d 446, 448 (2d Cir. 1964); see also *Eastgroup*, 935 F.2d at 249 (holding that the "existence of parent and intercorporate guarantees on loans" is a factor supporting a *prima facie* case for substantive consolidation); *Bonham*, 229 F.3d at 765 n.10 (same); *In re Gulfco Inv. Corp.*, 593 F.2d 921, 928 (10th Cir. 1979) (recognizing that bankruptcy court can eliminate intercorporate guarantees through substantive consolidation where there are "compelling equitable reasons for doing so").

In *Soviero*, the bankruptcy trustee sought an adjudication that the assets of 13 separate but related corporate affiliates were property of the debtor's estate and requested leave to sell fixtures of the affiliates free and clear of liens and encumbrances. The objecting creditor, which had previously lent money to the debtors and received chattel mortgages from the affiliates securing such loan, argued that the fixtures were property of the affiliates and thus the bankruptcy court lacked jurisdiction to adjudicate title to the affiliates' property because it was not property of the debtor's estate. On appeal, the Second Circuit affirmed that "there existed a unity of interest and ownership common to all corporations, and that to adhere to the separate corporate entities theory would result in an injustice to the bankrupt's creditors." 328 F.2d at 448. Emphasizing that "the bankrupt held up the veils of the [affiliates] primarily, if not solely, for the benefit of the tax gatherer, but otherwise completely disregarded them," the

Second Circuit combined the assets of the non-debtor affiliates with those of the debtor and eliminated the objecting creditors' security interest in the non-debtor affiliates, which arguably placed the objecting creditor in *Soviero* in an even stronger position than the Banks in this case that merely hold guarantees. *See id.* at 447-49. Had *Soviero* been decided under the Third Circuit's standard, the chattel mortgages issued by the affiliates in favor of the objecting creditor (like the guarantees held by the Banks) would have trumped all evidence of interrelatedness and would have precluded an order combining the assets of the debtor and its affiliates because, under the Third Circuit's standard, "obtaining the guarantees of separate entities . . . entitles a lender, in bankruptcy or out, to look to any (or all) guarantor(s) for payment when the time comes." Pet. App. 24a.

Other courts applying the pre-existing tests for substantive consolidation not only have refused to follow the Third Circuit's reasoning that the existence of guarantees is dispositive, but also have found the existence of subsidiary guarantees to be a substantial factor *weighing in favor of substantive consolidation*. These courts have reasoned that the presence of subsidiary guarantees was indicative of an interrelationship of companies within a larger corporate enterprise.

For instance, in *In re Manzey Land & Cattle Co.*, 17 B.R. 332 (Bankr. D.S.D. 1982), individual debtors and an affiliated corporate debtor filed a motion seeking to consolidate the individual debtors' estates with that of a related corporate debtor. A secured creditor of both the individual and corporate debtors opposed the motion. The objecting creditor argued that it had relied on the separate existence of the debtors in extending the loans at issue and that such reliance was evidenced by the fact that the objecting creditor obtained guarantees from the debtors in connection with the loans. *See id.* at 337. To the contrary, the court found that the existence of inter-debtor guarantees constituted a factor favoring substantive consolidation:

[T]he Court finds Creditor Bank's contention [that it relied on the separate existence of the debtors to be]

unpersuasive in light of the fact Creditor Bank required Corporate Debtor's loans be guaranteed by Individual Debtors. *The requirement of a guarantee indicates Creditor Bank recognized Corporate Debtor was merely the alter-ego of Individual Debtors.*

*Id.* (emphasis added); see *In re Affiliated Foods, Inc.*, 249 B.R. 770, 784 (Bankr. W.D. Mo. 2000) (granting substantive consolidation of debtor corporation and its two debtor subsidiaries, and pointing to the existence of intercorporate guarantees as a factor weighing in favor of substantive consolidation); *In re Eagle-Picher Indus., Inc.*, 192 B.R. 903 (Bankr. S.D. Ohio 1996) (granting substantive consolidation of Chapter 11 debtor with its incorporated divisions, and pointing to the existence of intercorporate guarantees as a factor weighing in favor of substantive consolidation); *In re Orfa Corp.*, 129 B.R. 404, 415-17 (Bankr. E.D. Pa. 1991) (citing both the *Auto-Train* and *Augie/Restivo* standards and finding substantive consolidation of three debtors appropriate over guaranteed creditor's objection and holding that the presence of intercompany guarantees was "indicative of an interrelationship of companies within a larger enterprise, and negate[d] the claim of separate reliance on creditors"); *In re Murray Indus., Inc.*, 119 B.R. 820 (Bankr. M.D. Fla. 1990) (granting substantive consolidation of estates of parent and subsidiary corporations, and pointing to the existence of intercorporate guarantees as a factor weighing in favor of substantive consolidation); *Holywell Corp. v. Bank of New York*, 59 B.R. 340, 348 (S.D. Fla. 1986) (affirming grant of substantive consolidation of five debtors' estates, and holding "[t]he existence of cross-claimants of guarantees on loans to other debtors" as a factor favoring substantive consolidation); *In re Nite Lite Inns*, 17 B.R. 367, 371 (Bankr. S.D. Cal. 1982) (confirming reorganization plan providing for substantive consolidation of corporate debtors with individual debtors, and finding that "substantive consolidation is in the best interests of creditors in this case because it eliminates the problems arising from the numerous cross-guarantees made by the individual debtors on corporate debts"); *In re Richton Int'l Corp.*, 12 B.R. 555, 557 (Bankr. S.D.N.Y. 1981) (substantively

consolidating parent company with two of its wholly owned subsidiaries, and pointing to the existence of cross-corporate guarantees as a factor weighing in favor of substantive consolidation); *see also Chemical Bank New York Trust Co. v. Kheel*, 369 F.2d 845 (2d Cir. 1966) (affirming district court's order granting motion of United States and reorganization trustees for substantive consolidation of several debtor estates over creditors' objections, including objections of bondholders who possessed a mortgage securing their claims and a guarantee issued by one of the debtors).<sup>7</sup>

*Second*, under *Auto-Train*, a court can use its equitable powers to order substantive consolidation – even where an objecting creditor makes the requisite showing of reliance on separateness and harm – if “it determines that the demonstrated benefits of consolidation ‘heavily’ outweigh the harm.” 810 F.2d at 276. This “third” element of the *Auto-Train* test, derived from the equitable powers of bankruptcy courts, is explicitly eliminated by the Third Circuit, which “disagree[d]” with the approach adopted by other circuit courts on this issue. *See* Pet. App. 19a. In the Third Circuit's view, “[i]f an objecting creditor relied on the separateness of the entities, consolidation cannot be justified *vis-à-vis* the claims of that creditor.” *Id.* at 20a.

Again, this difference in approach leads to conflicting results, depending upon the circuit in which the bankruptcy petition is filed. In this case, for instance, the District Court made numerous factual findings demonstrating the substantial benefits of substantive consolidation, including findings that substantive consolidation would “greatly simplify and expedite the successful completion of this entire bankruptcy proceeding,” and that it “would be exceedingly difficult to untangle the financial affairs of the various entities.” *Id.* at 35a. Given the District Court's substantial fact-finding, if

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<sup>7</sup> The District Court in this case also found that the existence of the subsidiary guarantees was a factor weighing in favor of substantive consolidation. *See* Pet. App. 36a (“[T]he very existence of these cross-guarantees is a further reason for approving substantive consolidation.”).

this case had been filed in a circuit that followed *Auto-Train*, the result here would have been different.

*Third*, the Third Circuit concluded that the debtors and their affiliates may not be “deemed” consolidated for bankruptcy purposes if their corporate forms are not actually consolidated. *See id.* at 29a. Neither the Bankruptcy Code, *Augie/Restivo*, *Auto-Train*, nor any other court applying any of the available standards for substantive consolidation has set forth such a prohibition.

The Third Circuit’s ruling thus directly conflicts with the approach followed in the Sixth Circuit and several other courts on this issue. *See, e.g., In re American HomePatient, Inc.*, 298 B.R. 152 (Bankr. M.D. Tenn. 2003), *aff’d*, 420 F.3d 559 (6th Cir. 2005) (affirming bankruptcy court’s order confirming plan of reorganization providing for a deemed consolidation of debtors). Many courts have explicitly found there to be no material difference between “deemed” and “actual” consolidations. *See, e.g., In re Standard Brands Paint Co.*, 154 B.R. 563, 570 (Bankr. C.D. Cal. 1993) (“viewing substantive consolidation as being a merger of corporations unnecessarily decreases the flexibility of the doctrine”). Moreover, section 1123 of the Bankruptcy Code expressly states that a Chapter 11 plan shall “provide adequate means for the plan’s implementation, such as . . . merger *or* consolidation of the debtor with one or more persons,” and does not make any such distinction. 11 U.S.C. § 1123(a)(5)(C) (emphasis added); *see Standard Brands*, 154 B.R. at 573 (“[T]he court does not view consolidation as requiring actual merger of the entities, due to the ‘merger or consolidation’ wording of Section 1123(a)(5)(C).”). As one court explained:

[T]here is a distinction between the legal merger of two corporations and the merger of their bankruptcy estates. With substantive consolidation the estates are merged for the purposes of bankruptcy administration, but the consolidation alone does not effect a corporate merger. In many cases substantive consolidation will be accompanied by merger of the legal entities, *but that is not invariable*.

*In re Deltacorp, Inc.*, 179 B.R. 773, 778 (Bankr. S.D.N.Y. 1995) (emphasis added; footnote omitted); *see also Standard Brands*, 154 B.R. at 570 (holding that the bankruptcy court has the power to order a "deemed" substantive consolidation if the benefits outweigh any harm).

The court in *American HomePatient* confirmed a Chapter 11 plan providing for deemed consolidation that eliminated secured creditors' rights to recover from subsidiary guarantor debtors. The secured lenders objected, arguing that substantive consolidation would eliminate their rights to recover from the assets of the subsidiary debtors. *See* 298 B.R. at 164. With findings of fact virtually identical to those of the District Court in the case at bar (*i.e.*, interlocking officers and directors, wholly owned subsidiaries, financial statements and federal tax returns done on a consolidated basis, only parent company was obligor, subsidiaries were guarantors, lenders required only consolidated reporting, and substantive consolidation was consistent with the overall business operations of the debtor), the *American HomePatient* court denied the secured lenders' objection and confirmed the plan, which provided that "[t]he separate corporate structures of the Debtors shall continue." *Id.* Notably, the court found that the filing of separate state tax returns did not support the objecting creditors' assertions of separateness since this was done "solely for tax reasons." *Id.* at 166 n.10; *see also Eagle-Picher*, 192 B.R. at 907 ("[I]t is well established that retention of corporate form for the purpose of securing tax benefits presents no obstacle to substantive consolidation.").

Similarly, many courts have approved Chapter 11 plans of reorganization providing for "deemed" consolidations without questioning its propriety. *See In re Genesis Health Ventures, Inc.*, 266 B.R. 591, 619 (Bankr. D. Del. 2001) (confirming reorganization plan providing for deemed consolidation, which eliminated intercompany guarantees over objections of senior subordinated noteholders and general unsecured creditors); *see also Debtors' Modified Second Amended Joint Plan of Reorganization Under Chapter 11 of the Bankruptcy Code at 25, In re WorldCom, Inc.*, Case No.

02-13533, Docket No. 9525 (Bankr. S.D.N.Y. filed Oct. 21, 2003) (“[t]he substantive consolidation effected pursuant to Section 5.01(a) of the Plan shall not (other than for purposes related to funding distributions under the Plan and as set forth above in this section) affect . . . the legal and organizational structure of the WorldCom Debtors”); Findings of Fact, Conclusions of Law, and Order Under 11 U.S.C. §§ 1129(a) and (b) and Fed. R. Bankr. P. 3020 Confirming the First Amended Joint Plan of Reorganization of Kmart Corporation and Its Affiliated Debtors and Debtors-in-Possession, As Modified, at 82, *In re Kmart Corp.*, Case No. 02-B02474, Docket No. 10871 (Bankr. N.D. Ill. Apr. 22, 2003) (“[e]xcept as set forth in this Article, such substantive consolidation will not (other than for purposes related to this Plan) . . . affect the legal and corporate structures of the Debtors or Reorganized Debtors”); Order Confirming Supplemental Modified Fifth Amended Joint Plan of Affiliated Debtors Pursuant to Chapter 11 of the United States Bankruptcy Code, and Related Relief, *In re Enron Corp.*, Case No. 01-16034, Docket No. 19759 (Bankr. S.D.N.Y. July 15, 2004) (in plan incorporating resolution of substantive consolidation litigation, providing that affiliated entities will not be combined); Order Pursuant to Section 1129(a) of the Bankruptcy Code and Rule 3020 of the Federal Rules of Bankruptcy Procedure Confirming Debtors’ Joint Plan of Reorganization at 9, *In re Global Crossing Ltd.*, Case No. 02-40188, Docket No. 2586 (Bankr. S.D.N.Y. Dec. 26, 2002) (“Deemed consolidation for voting and distribution purposes only in these chapter 11 cases is appropriate and warranted in light of the evidence adduced at the Confirmation Hearing.”); Findings of Fact, Conclusions of Law, and Order Under 11 U.S.C. §§ 1129(a) and (b) and Fed. R. Bankr. P. 3020 Confirming the First Amended Joint Plan of Reorganization of Comdisco, Inc. and Its Affiliated Debtors and Debtors in Possession at 21, *In re Comdisco, Inc.*, Case No. 01-24795, Docket No. 2779 (Bankr. N.D. Ill. July 31, 2002) (in plan providing for substantive consolidation, finding that “each Reorganized Debtor shall continue to exist after the Effective Date as a separate corporate entity, with all the powers of a corporation . . . under applicable state

or foreign law"); Debtors' Third Amended Joint Plan of Reorganization Under Chapter 11 of the Bankruptcy Code at 88-89, *In re Adelphia Communications Corp.*, Case No. 02-41729, Docket No. 8599 (Bankr. S.D.N.Y. filed Sept. 28, 2005) (combining entities for some purposes and effecting a deemed consolidation for voting and distribution purposes).

In contrast to the decisions of all these other courts, in the Third Circuit a substantive consolidation plan is now *necessarily* unlawful if it does not provide for the actual consolidation of the debtors' estates under state corporate law. See Pet. App. 29a.

*Fourth*, the Third Circuit requires a significantly greater showing of interrelatedness of affiliated corporate entities than is required in other courts. As noted above, the *Auto-Train* line of cases requires a showing of only "substantial identity" to justify substantive consolidation. See, e.g., *East-group*, 935 F.2d at 249. Under *Augie/Restivo*, proponents need only establish that creditors "dealt with" the entities as a single unit. 860 F.2d at 518. By contrast, the Third Circuit requires a showing that the entities for whom substantive consolidation is being sought "disregarded separateness so significantly their creditors relied on the breakdown of entity borders and treated them as one legal entity." Pet. App. 22a.

These distinct standards lead to meaningfully different results. In this case itself, the District Court applied the *Auto-Train* "substantial identity" test used in the D.C., Eighth, and Eleventh Circuits, and concluded that substantive consolidation was amply justified under that standard. As the District Court explained:

I have no difficulty in concluding that there is indeed substantial identity between the parent debtor OCD and its wholly-owned subsidiaries. All of the subsidiaries were controlled by a single committee, from central headquarters, without regard to the subsidiary structure. Control was exercised on a product-line basis. For example, the president of the insulating systems business managed all aspects of the production, marketing, and distribution of insulation prod-

ucts, regardless of whether those products were manufactured in a factory owned by OCD or by a foreign subsidiary. The officers and directors of the subsidiaries did not establish business plans or budgets, and did not appoint senior management except at the direction of the central committee . . . . Subsidiaries were established for the convenience of the parent company, primarily for tax reasons. All of the subsidiaries were dependent upon the parent company for funding and capital. The financial management of the entire enterprise was conducted in an integrated manner. No subsidiary exercised control over its own finances.

*Id.* at 34a-35a.

The Third Circuit notably did not conclude that any of the District Court's factual findings were "clearly erroneous," yet it nevertheless determined that, despite the overwhelming evidence of corporate interrelatedness, substantive consolidation was improper under the new mode of analysis it molded in its decision. Application of the Third Circuit's new standard led directly to a different result than was reached by District Court applying the legal standard in the D.C., Eighth, and Eleventh Circuits. *See id.* at 24a.

It is a virtual certainty that the Eleventh Circuit's decision in *Eastgroup* (applying the *Auto-Train* standard) and the Ninth Circuit's decision in *Bonham* (applying the *Augie-Restivo* standard) would have been different had those courts been required to apply the Third Circuit's mode of analysis in those cases. The *Eastgroup* court found that the proponent of substantive consolidation established a *prima facie* case based on the existence of a number of factors, including (i) common ownership, officers, employees, and physical facilities, (ii) transfers of funds among the affiliates, and (iii) confusion among creditors regarding which entity owned which assets. *See* 935 F.2d at 247, 250. The Eleventh Circuit further found that the objecting creditor (a landlord) failed to defeat the trustee's *prima facie* case by making the requisite showing that it had relied on corporate separateness,

notwithstanding (i) testimony by a senior officer of the affiliated entities that they "held themselves out to the public and to their creditors as separate corporations" and (ii) the fact that the objecting creditor commenced a lawsuit in order to determine which of the debtors was contractually obligated as its tenant. *Id.* at 251-52. In reaching its conclusion, the Eleventh Circuit was careful not to equate the appearance of separateness on a creditor's actual reliance on separateness: "That [the debtors] may have, in general, held themselves out to the public and to their creditors as separate corporations does not mean that [the objecting creditor] did not rely on the credit of both corporations." *Id.* at 252. The objecting creditor's evidence of reliance on separateness in *Eastgroup* likely would have been sufficient to defeat substantive consolidation under the Third Circuit's standard. Indeed, the Third Circuit's ruling instructs bankruptcy courts to ignore overwhelming evidence of corporate interrelatedness – which, under *Auto-Train*, results in a presumption of an objecting creditor's non-reliance on separateness – in favor of superficial evidence of reliance on separateness. *See* Pet. App. 22a.

Similarly, in *Bonham*, the Ninth Circuit relied on evidence much like that the Third Circuit rejected here to determine that substantive consolidation was appropriate. The *Bonham* court held that, "[i]n light of the substantial evidence . . . that [the debtor] commingled the assets of [the affiliates] and used their names interchangeably, [and] the lack of any independent financial statements . . . it is clear that the bankruptcy court did not err in crediting little weight to these affidavits and determining that the creditors could not have believed that they were dealing with separate entities." 229 F.3d at 767. That evidence is much like the evidence relied upon by the District Court in this case. The objecting creditors' "evidence" of reliance on separateness in *Bonham* (an affidavit from the objecting creditor) almost certainly would have defeated substantive consolidation under the Third Circuit's standard because, as the Third Circuit made clear, such evidence "can . . . defeat a *prima facie* showing" of substantive consolidation. Pet. App. 23a, 24a.

*Fifth*, the Third Circuit arbitrarily limited the use of substantive consolidation by prohibiting its use "to alter creditor rights." *Id.* at 22a. Contrary to the Third Circuit's conclusion, there is no prohibition on the use of substantive consolidation to redistribute the debtors' assets at the expense of one or more creditors under the Bankruptcy Code, *Augie/Restivo*, *Auto-Train*, or any other decision applying the standards for substantive consolidation, for that matter. On the contrary, pre-existing case law from other circuits recognizes that there will often be certain creditors that will receive a reduced distribution on their claim under a plan of reorganization that provides for substantive consolidation because "the entities to be consolidated are likely to have different debt-to-asset ratios, [and] consolidation 'almost invariably redistributes wealth among the creditors of the various entities.'" *Eastgroup*, 935 F.2d at 248 (quoting *Auto-Train*, 810 F.2d at 276); see also J. Stephen Gilbert, *Note: Substantive Consolidation in Bankruptcy: A Primer*, 43 Vand. L. Rev. 207, 210 (1990) ("The creditor of a debtor whose asset-to-liability ratio is higher than that of its affiliated debtor will receive a proportionately smaller satisfaction of its claim because the asset-to-liability ratio of the merged estates will be lower.").

The Third Circuit's limitation on a court's power to alter creditor rights, for all practical purposes, eliminates the use of substantive consolidation absent consent of all parties, and places significant restrictions on the bankruptcy courts' ability to achieve the most equitable result after assessing the relationship of creditors to the debtors. By its own admission, nothing less than a "perfect storm" justifies substantive consolidation. Pet. App. 30a. As Justice Douglas noted in *Sampsell*, however, "[t]he power of the bankruptcy court to subordinate claims or to adjudicate equities arising out of the relationship between the several creditors is complete." 313 U.S. at 219.

## II. THE THIRD CIRCUIT'S DECISION IS ERRONEOUS

The Third Circuit's holdings not only are contrary to the decisions of other courts, but also are erroneous on the merits.

The Third Circuit explicitly rejected and refused to follow the modern trend in other courts toward increased use of substantive consolidation in light of the unified manner in which many large corporate enterprises are operated in today's economy. *See* Pet. App. 19a n.15. As other circuit courts have recognized in similar cases, large corporate enterprises often are operated without regard for corporate separateness and creditors of such individual corporations within the enterprise thus frequently do not rely on their separate creditworthiness in extending credit. *See Eastgroup*, 935 F.2d at 248-49 (citing the "increased judicial recognition of the widespread use of interrelated corporate structures by subsidiary corporations operating under a parent entity's corporate umbrella for tax and business purposes"). In these situations, substantive consolidation treats all creditor constituencies fairly by giving creditors the benefit of their bargain with the consolidated enterprise. *Bonham*, 229 F.3d at 764 ("The primary purpose of substantive consolidation is to ensure the equitable treatment of all creditors.") (internal quotation marks omitted). That analysis applies fully here, where the District Court found as a matter of fact that OCD's creditors relied on the creditworthiness of the overall enterprise, as demonstrated by the facts that, among other things, they received only consolidated financial statements and did not know the debts incurred by any particular corporate subsidiary. *See* Pet. App. 35a. In such a circumstance in which there is no actual reliance on separateness, it is entirely consistent with the equitable nature of bankruptcy remedies to employ substantive consolidation.

As other courts have further recognized, substantive consolidation also is beneficial because it enables large debtor corporate enterprises to achieve reorganization in a streamlined and expedited fashion. Substantive consolidation

eliminates the need for debtor corporate affiliates that were operated as an enterprise prepetition to (i) file separate plans of reorganization, (ii) solicit and obtain votes by each class of creditors of each of the debtors, and (iii) reconcile innumerable intercompany claims. See Gilbert, *Substantive Consolidation in Bankruptcy: A Primer*, 43 Vand. L. Rev. at 209-10. Substantive consolidation avoids the risk that control over certain subsidiaries or valuable property rights held by certain subsidiaries that are integral to the enterprises' overall business will be lost when those subsidiaries are required to make separate distributions to their respective creditors. See *Bonham*, 229 F.3d at 764 ("Without the check of substantive consolidation, debtors could insulate money through transfers among inter-company shell corporations with impunity."). The Third Circuit erred in rejecting these benefits in circumstances where it is equitable to engage in substantive consolidation.

Moreover, the Third Circuit erred both in eliminating the bankruptcy courts' power to order substantive consolidation where the benefits "heavily" outweigh the harm and in prohibiting the use of substantive consolidation to "alter creditor rights." Pet. App. 19a, 22a. "Underlying Chapter 11 of the Code is a legislative policy to provide opportunities for a debtor to reduce or extend debts so that it can return to financial viability. 'The purpose of a business reorganization case . . . is to restructure a business's finances so that it may continue to operate, provide its employees with jobs, pay its creditors, and produce a return for its stockholders.'" *In re Bildisco*, 682 F.2d 72, 77 (3d Cir. 1982) (quoting H.R. Rep. No. 95-595, at 220 (1977), reprinted in 1978 U.S.C.C.A.N. 5963, 6179), *aff'd*, 465 U.S. 513 (1984). In overseeing this process, "the bankruptcy courts are necessarily entrusted with broad equitable powers to balance the interests of the affected parties, guided by the overriding goal of ensuring the success of the reorganization." *Pioneer Inv. Servs. Co. v. Brunswick Assocs. Ltd. P'ship*, 507 U.S. 380, 389 (1993). To this end, "[t]he especial purpose of all bankruptcy legislation is to interfere with the relations between the parties concerned – to change, modify, or impair the obligation of their contracts."

*Ashton v. Cameron County Water Improvement Dist. No. 1*, 298 U.S. 513, 530 (1936). Indeed, practically every section of the Bankruptcy Code effects a change in the pre-negotiated rights of creditors to receive full consideration for the obligations due. See *In re Sylmar Plaza, L.P.*, 314 F.3d 1070, 1075 (9th Cir. 2002) (citing *In re PPI Enters., Inc.*, 228 B.R. 339, 344-45 (Bankr. D. Del. 1998) (collecting Bankruptcy Code provisions that directly alter parties' pre-petition contractual rights), *aff'd*, 324 F.3d 197 (3d Cir. 2003)). Accordingly, the Third Circuit was incorrect in placing broad restrictions on bankruptcy courts' equitable powers to facilitate the reorganization process through substantive consolidation.

Additionally, in reversing the District Court, the Third Circuit took issue with what it perceived to be the "deemed" use of substantive consolidation in this case. See Pet. App. 29a. There are simply no bases in statute or precedent for this sweeping conclusion. On the contrary, as noted above, section 1123(a)(5)(C) of the Bankruptcy Code, which states that a Chapter 11 plan shall "provide adequate means for the plan's implementation, such as . . . merger *or* consolidation of the debtor with one or more persons," does not make any such distinction. 11 U.S.C. § 1123(a)(5)(C) (emphasis added). Nor is there any reason to read such a limitation into Congress's enactment. Consolidation for purposes of bankruptcy proceedings serves distinct purposes relating to equitable distribution of assets and prompt resolution of disputes without the waste involved in trying to sort out intercorporate transfers. Those purposes do not necessarily require legal consolidation of entities, and there is no reason to mandate such legal consolidation (or to assume that Congress did so) as a condition of obtaining the benefits of substantive consolidation.

### III. THE THIRD CIRCUIT'S DECISION IS SIGNIFICANT AND ADDS TO THE PREVAILING UNCERTAINTY ON THIS ISSUE

This Court has previously granted certiorari where the lower courts have adopted multiple, inconsistent standards on a significant bankruptcy issue. *See Associates Commercial*, 520 U.S. at 959. More generally, the Court frequently grants certiorari to resolve circuit splits in the field of bankruptcy law. *See, e.g., Rousey v. Jacoway*, 125 S. Ct. 1561 (2005) (granting certiorari to resolve division among circuits regarding whether debtors can exempt IRAs from the bankruptcy estate under 11 U.S.C. § 522(d)(10)(E)); *Till v. SCS Credit Corp.*, 541 U.S. 465 (2004) (granting certiorari to address split among circuits concerning the appropriate method to calculate the interest rate to be paid on loan to an objecting creditor); *Kontrick v. Ryan*, 540 U.S. 443 (2004) (granting certiorari to resolve division among circuits regarding whether Federal Rule of Bankruptcy Procedure 4004 is jurisdictional or may be waived by the debtor); *Lamie v. United States Tr.*, 540 U.S. 526 (2004) (granting certiorari to address split among circuits concerning whether a Chapter 7 debtor's attorney may be compensated pursuant to section 330(a)(1) of the Bankruptcy Code absent bankruptcy court approval under section 327); *Archer v. Warner*, 538 U.S. 314 (2003) (granting certiorari to address split among circuits concerning the dischargeability of a debtor's debt for money promised as part of a settlement agreement).

The case for granting certiorari to resolve the acknowledged circuit split here is particularly compelling. In today's economy, large corporate enterprises often are operated without regard for the corporate separateness of affiliated members of the same corporate family. *See Eastgroup*, 935 F.2d at 248-49. For that reason, the "trend" is toward allowing substantive consolidation with increasing frequency in corporate bankruptcies. *Id.* at 248. Indeed, as noted at the outset, the plans of reorganization in seven of the ten largest bankruptcy cases in the five-year period from 2000 through 2004, including those in *Enron* and *WorldCom*, were predicated on

substantive consolidation. *See* Widen at 9.<sup>8</sup> Professor Widen noted that the use of substantive consolidation to craft reorganization plans has been a “significant part of the bankruptcy lawyers’ toolbox[.]” for at least a decade prior to the period from 2000 through 2004. *Id.* at 5. Thus, it is clear that this issue has become vitally important to the reorganization process in large bankruptcy cases.

The need for a decision by this Court clarifying the proper approach to substantive consolidation is further confirmed by an opposing amicus brief filed by a group of seven legal academics. *See* Brief Amicus Curiae in Support of the Appellant, *In re Owens Corning*, No. 04-4080 (3d Cir. filed Dec. 29, 2004). Although these academics disagreed with the result reached by the District Court, they emphasized the need for “clarity” in this area and the “danger” posed by the current circumstances under which there are “differing tests with a myriad of factors.” *Id.* at 4, 11. These same factors argue strongly for a grant of certiorari, so that there can be clarity in all lower courts on this frequently recurring issue.

In this regard, it also is important to note that the current uncertainty on these issues affects parties’ primary conduct by negatively impacting the business community and the willingness of creditors to extend credit to corporations. Given the array of decisions on the standard for substantive consolidation, and the extreme range of potential outcomes, creditors are at a loss as to what risks they face. This problem is particularly acute for creditors of companies that could file a bankruptcy petition in more than one jurisdiction as there is little predictability as to what circuit’s standard will apply. The Second Circuit acknowledged the importance of certainty in the credit markets in *Augie/Restivo*: “[L]enders’ expectations are central to the calculation of interest rates and other terms of loans, and fulfilling those expectations is therefore important to the efficiency of credit markets.” 860 F.2d at 519. Even one commentator who has expressed res-

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<sup>8</sup> The ranking of bankruptcy cases in Professor Widen’s article is based on pre-filing asset size and adjusts to current dollars. *See* Widen at 3 n.9.

ervations concerning substantive consolidation has reached a similar conclusion:

The risk of consolidation may be crucial to creditors' lending decisions; as such, creditors need to know ex ante the presence of such risk. If consolidation is likely, or even possible, creditors need to evaluate and extend credit based upon the financial health of not just the legal entity to which they lend, but also its relations. The issue is not merely academic [but] . . . importan[t] to the business community [as well]. . . . Unfortunately, it is virtually impossible to predict when related entities will be consolidated. The substantive consolidation decisions espouse numerous standards that are susceptible to broad variations in application[.]

Kors, *Altered Egos: Deciphering Substantive Consolidation*, 59 U. Pitt. L. Rev. at 384.

Finally, the standard for substantive consolidation articulated by the Third Circuit will inhibit the negotiations that should occur between the various creditor constituencies and debtors in connection with seeking consensus on a debtor's plan of reorganization. While the objections to substantive consolidation in *Enron* and *WorldCom* ultimately were resolved consensually, it is unlikely that there would have been a resolution of the issue if the Third Circuit's decision had been controlling in those two bankruptcy cases, which were filed in the Second Circuit (*i.e.*, a jurisdiction following the *Augie/Restivo* standard). Because an objecting creditor is afforded virtual veto power over substantive consolidation under the Third Circuit's decision, and because the decision eliminates "deemed" consolidations, objecting creditors are left with little (if any) incentive to compromise on the issue. Accordingly, if the substantive consolidation standard set forth in the decision is allowed to stand, it will have a significant negative impact on large corporate reorganizations.

### CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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## **APPENDIX**

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UNITED STATES COURT OF APPEALS  
FOR THE THIRD CIRCUIT

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No. 04-4080

IN RE: OWENS CORNING, A DELAWARE CORPORATION

CREDIT SUISSE FIRST BOSTON, AS AGENT FOR  
THE PREPETITION BANK LENDERS,  
*Appellant,*

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Appeal from the United States Bankruptcy Court  
for the District of Delaware

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Argued Feb. 7, 2005  
Opinion filed Aug. 15, 2005

As Amended Aug. 23, 2005,  
Sept. 2, 2005 and Oct. 12, 2005

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Before ROTH, AMBRO and FUENTES, Circuit Judges.

OPINION OF THE COURT

AMBRO, Circuit Judge.

We consider under what circumstance a court exercising bankruptcy powers may substantively consolidate affiliated entities. Appellant Credit Suisse First Boston ("CSFB") is the agent for a syndicate of banks (collectively, the "Banks")<sup>1</sup> that extended in 1997 a \$2 billion unsecured loan to Owens Corning, a Delaware corporation ("OCD"), and certain of its subsidiaries. This credit was enhanced in part by guarantees

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<sup>1</sup> Though CSFB is the named appellant, the real parties in interest are the Banks (which include CSFB). Thus, unless the context requires otherwise, CSFB and the Banks are referred to interchangeably in this opinion.

made by other OCD subsidiaries. The District Court granted a motion to consolidate the assets and liabilities of the OCD borrowers<sup>2</sup> and guarantors in anticipation of a plan of reorganization.

The Banks appeal and argue that the Court erred by granting the motion, as it misunderstood the reasons for, and standards for considering, the extraordinary remedy of substantive consolidation, and in any event did not make factual determinations necessary even to consider its use. Though we reverse the ruling of the District Court, we do so aware that it acted on an issue with no opinion on point by our Court and differing rationales by other courts.

While this area of law is difficult and this case important, its outcome is easy with the facts before us. Among other problems, the consolidation sought is "deemed." Should we approve this non-consensual arrangement, the plan process would proceed as though assets and liabilities of separate entities were merged, but in fact they remain separate with the twist that the guarantees to the Banks are eliminated. From this we conclude that the proponents of substantive consolidation request it not to rectify the seldom-seen situations that call for this last-resort remedy but rather as a ploy to deprive one group of creditors of their rights while providing a wind-fall to other creditors.

## **I. Factual Background and Procedural History**

### **A. Owens Corning Group of Companies**

OCD and its subsidiaries (which include corporations and limited liability companies) comprise a multinational corporate group. Different entities within the group have different purposes. Some, for example, exist to limit liability concerns (such as those related to asbestos), others to gain tax benefits, and others have regulatory reasons for their formation.

Each subsidiary was a separate legal entity that observed governance formalities. Each had a specific reason to exist separately, each maintained its own business records, and

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<sup>2</sup> For ease of reference, we refer hereinafter solely to OCD as the borrower.

intercompany transactions were regularly documented.<sup>3</sup>

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<sup>3</sup> For example, Owens-Corning Fiberglass Technology, Inc. ("OCFT") was created as an intellectual property holding company to which OCD assigned all of its domestic intellectual property. OCFT licensed this intellectual property back to OCD in return for royalty payments. OCFT also entered into licensing agreements with parties outside of the OCD family of companies. This structure served to shield OCD's intellectual property assets (valued at over \$500 million) from liability. OCFT operated as an autonomous entity. It prepared its own accounting and financial records and paid its own expenses from its separate bank accounts. OCFT had its own employees working at its Summit, Illinois plant, which contained machinery and equipment for research and development.

IPM, Inc. ("IPM") was incorporated as a passive Delaware investment holding company by OCD to consolidate the investments of its foreign subsidiaries. IPM shielded the foreign subsidiaries' investments from OCD liability and likewise shielded OCD from the liability of those foreign subsidiaries. OCD transferred ownership of its foreign subsidiaries to IPM and entered into a revolving loan agreement under which IPM loaned dividends from those subsidiaries to OCD. OCD paid interest on this revolving loan. IPM, like OCFT, entered into agreements with parties unaffiliated with the OCD group and operated as an autonomous entity. IPM also prepared its own accounting and financial records and paid its own expenses from its separate bank accounts. IPM's officers oversaw all investment activity and maintained records of investment activity in IPM subsidiaries.

Both OCFT and IPM operated outside of OCD's business units. Neither company received administrative support from OCD and both paid payroll and business expenses from their own accounts. Although summaries of their accounting ledgers were entered into OCD's centralized cash management system, the underlying records were created and maintained by the subsidiaries, not OCD. OCFT and IPM even had their own company logos and trade names.

Integrex was formed by OCD as an asbestos liability management company. For OCD's asbestos liability, Integrex ultimately processed only settled asbestos claims. The company also provided professional services (such as litigation management and materials testing) to the public. It had its own trade name and trademarked logo, its own business unit and its own financial team for business planning, and began several startup businesses that ultimately failed.

As discussed at Section I(B), *infra*, in 1997 OCD acquired Fibreboard Corporation. Subsequently, OCD formed Exterior Systems, Inc. ("ESI") as a separate entity after several subsidiaries of Fibreboard merged in

Although there may have been some "sloppy" bookkeeping, two of OCD's own officers testified that the financial statements of all the subsidiaries were accurate in all material respects. Further, through an examination of the subsidiaries' books, OCD's postpetition auditors (Ernst & Young) have eliminated most financial discrepancies, particularly with respect to the larger guarantor subsidiaries.

### **B. The 1997 Credit Agreement**

In 1997 OCD sought a loan to acquire Fibreboard Corporation. At this time OCD faced growing asbestos liability and a poor credit rating that hindered its ability to obtain financing. When CSFB was invited to submit a bid, it included subsidiary guarantees in the terms of its proposal. The guarantees gave the Banks direct claims against the guarantors for payment defaults. They were a "credit enhancement" without which the Banks would not have made the loan to OCD. All draft loan term sheets included subsidiary guarantees.

A \$2 billion loan from the Banks to OCD closed in June 1997. The loan terms were set out primarily in a Credit Agreement. Among those terms were the guarantee provisions and requirements for guarantors, who were defined as "present or future Domestic Subsidiar[ies] . . . having assets with an aggregate book value in excess of \$30,000,000." Section 10.07 of the Agreement provided that the guarantees were "absolute and unconditional" and each "constitute[d] a guarant[ee] of payment and not a guarant[ee] of collection."<sup>4</sup>

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1999 in order to shield itself from successor liability for Fibreboard's asbestos products. Although the directors and managers of ESI and OCD overlapped, ESI observed corporate formalities in electing its directors and appointing its officers. In addition, it filed its own tax returns and kept its own accounting records. ESI held substantial assets, including over \$1 billion in property, 20 factories, and between 150 and 180 distribution centers.

<sup>4</sup> This standard guarantee term means simply that, once the primary obligor (here OCD) defaults, the Banks can proceed against the guarantors directly and immediately without first obtaining a judgment against OCD and collecting against that judgment to determine if a shortfall from OCD exists.

A "No Release of Guarantor" provision in § 10.8 stated that "the obligations of each guarantor . . . shall not be reduced, limited or terminated, nor shall such guarantor be discharged from any such obligations, for any reason whatsoever," except payment and performance in full or through waiver or amendment of the Credit Agreement. Under § 13.05 of the Credit Agreement, a guarantor could be released only through (i) the unanimous consent of the Banks for the guarantees of Fibreboard subsidiaries or through the consent of Banks holding 51% of the debt for other subsidiaries, or (ii) a fair value sale of the guarantor if its cumulative assets totaled less than 10% of the book value of the aggregate OCD group of entities.

CSFB negotiated the Credit Agreement expressly to limit the ways in which OCD could deal with its subsidiaries. For example, it could not enter into transactions with a subsidiary that would result in losses to that subsidiary. Importantly, the Credit Agreement contained provisions designed to protect the separateness of OCD and its subsidiaries. The subsidiaries agreed explicitly to maintain themselves as separate entities. To further this agreement, they agreed to keep separate books and financial records in order to prepare separate financial statements. The Banks were given the right to visit each subsidiary and discuss business matters directly with that subsidiary's management. The subsidiaries also were prohibited from merging into OCD because both entities were required to survive a transaction under § 8.09(a)(ii)(A) of the Credit Agreement. This provision also prohibited guarantor subsidiaries from merging with other subsidiaries unless there would be no effect on the guarantees' value.

### **C. Procedural History**

On October 5, 2000, facing mounting asbestos litigation, OCD and seventeen of its subsidiaries (collectively, the "Debtors") filed for reorganization under Chapter 11 of the Bankruptcy Code, 11 U.S.C. § 1101 *et seq.*<sup>5</sup> Twenty-seven

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<sup>5</sup> For convenience we refer hereinafter simply to "Bankruptcy Code § \_\_\_\_" when citing to a Code section.

months later, the Debtors and certain unsecured creditor groups (collectively, the "Plan Proponents") proposed a reorganization plan (as amended, the "Plan") predicated on obtaining "substantive consolidation" of the Debtors along with three non-Debtor OCD subsidiaries.<sup>6</sup> Typically this arrangement pools all assets and liabilities of the subsidiaries into their parent and treats all claims against the subsidiaries as transferred to the parent. In fact, however, the Plan Proponents sought a form of what is known as a "deemed consolidation," under which a consolidation is deemed to exist<sup>7</sup> for purposes of valuing and satisfying creditor claims, voting for or against the Plan, and making distributions for allowed claims under it. Plan § 6.1. Yet "the Plan would not result in the merger of or the transfer or commingling of any assets of any of the Debtors or Non-Debtor Subsidiaries, . . . [which] will continue to be owned by the respective Debtors or Non-Debtors." Plan § 6.1(a). Despite this, on the Plan's effective date "all guarantees of the Debtors of the obligations of any other Debtor will be deemed eliminated, so that any claim against any such Debtor and any guarantee thereof . . . will be deemed to be one obligation of the Debtors with respect to the consolidated estate." Plan § 6.1(b). Put another way, "the Plan eliminates the separate obligations of the Subsidiary Debtors arising from the guarant[c]es of the 1997 Credit Agreement." Plan Disclosure Statement at A-9897.

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<sup>6</sup> As the Plan's consolidation provisions affected so significantly voting on the Plan and the manner of proceeding at any confirmation hearing, the Plan Proponents filed a motion for a ruling on consolidation in anticipation of those events. "While not a routine procedure, it is not at all unusual for a plan proponent, or a plan opponent, to seek a determination prior to the plan confirmation hearing as to the legitimacy of a particular provision of a proposed plan." *In re Stone & Webster, Inc.*, 286 B.R. 532, 542 (Bankr.D.Del.2002) (Walsh, J.).

<sup>7</sup> "[A]ll assets and liabilities of each Subsidiary Debtor . . . will be treated as though they were merged into and with the assets and liabilities of OCD. . . ." Plan § 6.1(b) (emphasis added).

The Banks objected to the proposed consolidation. Judge Alfred Wolin held a hearing on this objection.<sup>8</sup> He was subsequently recused from the Debtors' bankruptcy proceedings in light of *In re Kensington Int'l Ltd.*, 368 F.3d 289 (3d Cir.2004), and Judge John Fullam was designated by the Chief Judge of our Court to replace him. Judge Fullam reviewed the transcripts and exhibits of the hearing, ordered additional briefing and on October 5, 2004, granted the consolidation motion in an order accompanied by a short opinion. *In re Owens Corning*, 316 B.R. 168 (Bankr. D.Del.2004).

Judge Fullam concluded that there existed "substantial identity between . . . OCD and its wholly-owned subsidiaries." *Id.* at 171. He further determined that "there [was] simply no basis for a finding that, in extending credit, the Banks relied upon the separate credit of any of the subsidiary guarantors." *Id.* at 172. In Judge Fullam's view, it was "also clear that substantive consolidation would greatly simplify and expedite the successful completion of this entire bankruptcy proceeding. More importantly, it would be exceedingly difficult to untangle the financial affairs of the various entities." *Id.* at 171. As such, he held substantive consolidation should be permitted, as not only did it allow "obvious advantages . . . [but was] a virtual necessity." *Id.* at 172. In any event, Judge Fullam wrote, "[t]he real issue is whether the Banks are entitled to participate, *pari passu*, with other unsecured creditors, or whether the Banks' claim is entitled to priority, in whole or in part, over the claims of other unsecured creditors." *Id.* But this issue, he stated, "cannot now be determined." *Id.*

CSFB appeals on the Banks' behalf.

## II. Appellate Jurisdiction

The Plan Proponents moved to dismiss the appeal of the District Court's order granting consolidation on the ground

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<sup>8</sup> Pursuant to 28 U.S.C. § 157(d), Judge Wolin withdrew the reference of, *inter alia*, the consolidation motion to the Bankruptcy Court, thus making the District Court the judicial forum for the motion to proceed.

that it is not a “final decision” from which an appeal may be taken pursuant to 28 U.S.C. § 1291.<sup>9</sup> We denied that motion prior to oral argument in this case and noted that our reasoning would follow in this opinion.

Recognizing the “protracted nature of many bankruptcy proceedings, and the waste of time and resources that might result if immediate appeal [is] denied,” *United States Trustee v. Gryphon at the Stone Mansion, Inc.*, 166 F.3d 552, 556 (3d Cir.1999), “[w]e apply a broader concept of ‘finality’ when considering bankruptcy appeals under § 1291 than we do when considering other civil orders under the same section.” *In re Marvel Entm’t Group, Inc.*, 140 F.3d 463, 470 (3d Cir.1998). See also *Buncher Co. v. Official Comm. of Unsecured Creditors of GenFarm Ltd. P’ship IV*, 229 F.3d 245, 250 (3d Cir.2000) (noting that we impose a “relaxed standard” of finality because of unique considerations in bankruptcy cases); 16 Charles A. Wright, Arthur R. Miller & Edward H. Cooper, *Federal Practice & Procedure* § 3926.2 at 274 (2d ed.1996) (describing the “Third Circuit’s especially flexible approach to bankruptcy finality”). Particularly relevant to our case is that “[t]o delay resolution of discrete claims until after final approval of a reorganization plan . . . would waste time and resources, particularly if the appeal resulted in reversal of a bankruptcy court order necessitating re-appraisal of the entire plan.” *Clark v. First State Bank (In re White Beauty View, Inc.)*, 841 F.2d 524, 526 (3d Cir. 1988). We have also stressed that “issues central to the progress of the bankruptcy petition, those ‘likely to affect the distribution of the debtor’s assets, or the relationship among the creditors,’ should be resolved quickly.” *Century Glove, Inc. v. First Am. Bank*, 860 F.2d 94, 98 (3d Cir.1988) (quoting *Southeastern Sprinkler Co., Inc. v. Meyertech Corp. (In re Meyertech)*, 831 F.2d 410, 414 (3d Cir.1987)).

We consider four factors in determining whether we should exercise jurisdiction over a bankruptcy appeal: “(1) [t]he

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<sup>9</sup> This provision, rather than 28 U.S.C. § 158(d), applies when the reference to a bankruptcy court is withdrawn.

impact on the assets of the bankrupt estate; (2) [the] [n]ecessity for further fact-finding on remand; (3) [t]he preclusive effect of [the Court's] decision on the merits of further litigation; and (4) [t]he interest of judicial economy." *Buncher*, 229 F.3d at 250. All four factors weigh heavily in favor of our jurisdiction to consider the appeal of an order granting substantive consolidation. We thus join the four Courts of Appeal that have exercised jurisdiction in this context. *Alexander v. Compton (In re Bonham)*, 229 F.3d 750, 762 (9th Cir.2000); *First Nat'l Bank of El Dorado v. Giller (In re Giller)*, 962 F.2d 796, 797-98 (8th Cir.1992); *East-group Props. v. S. Motel Ass'n*, 935 F.2d 245, 248 (11th Cir.1991); and *Union Sav. Bank v. Augie/Restivo Baking Co., Ltd. (In re Augie/Restivo Baking Co., Ltd.)*, 860 F.2d 515, 516-17 (2d Cir.1988).

First, substantive consolidation has a profound effect on the assets of the consolidated entities. See, e.g., *Nesbit v. Gears Unlimited*, 347 F.3d 72, 86-87 (3d Cir.2003). Second, there is no need for additional fact-finding to assess the propriety of an order granting substantive consolidation. In this case, for example, Judge Fullam reached his decision after a thirteen-day evidentiary hearing was held by Judge Wolin, and after Judge Fullam reviewed "the transcript of the testimony, and . . . the voluminous documentary record compiled in the course of the hearing, and [had] the benefit of post-trial briefing and argument." *In re Owens Corning*, 316 B.R. at 169. Third, a substantive consolidation order clearly has a preclusive effect on the merits of further litigation. In this case, the order precludes at least the Banks from asserting any right compromised or eliminated by virtue of the substantive consolidation. Last, the interests of judicial economy are best served by an immediate review of a substantive consolidation order. A later reversal of such an order risks rendering meaningless any proceedings premised on the viability of a plan that calls for a consolidation (even if for only a temporary period).

Having concluded that we generally have jurisdiction to review appeals of substantive consolidation orders, we

inquire whether anything is “different” about this case. The Plan Proponents argue that

[t]he District Court Order lacks finality because it will be implemented, if at all, only following approval of a disclosure statement, the solicitation and vote of creditors as to the terms of the Proposed Plan, and, assuming the requisite vote, final confirmation of the Proposed Plan, before which creditors other than the Bank Debt Holders shall be given the opportunity to contest substantive consolidation. [Bankruptcy Code] § 1129. Thus, the District Court Order is conditioned upon plan confirmation. . . . The District Court Order has no present impact on the Debtors’ estates and does not change the status quo.

Plan Proponents’ Mot. to Dismiss at 10. In support of this contention, the Plan Proponents rely primarily on *In re A.S.K. Plastics, Inc.*, No. Civ. A. 04-2701, 2004 WL 1903322 (E.D. Pa. Aug. 24, 2004). Yet the conclusion that the Court lacked jurisdiction in *A.S.K. Plastics* was premised on the fact that “[u]nder no reasonable construction of the law could the Order’s *conditional* consolidation be viewed as effect[ing] a ‘practical termination’ of anything.” *Id.* at \*2 (emphasis in original). That order “emphasized [that] . . . [w]hen a final reorganization plan [was] submitted to the Bankruptcy Court, [the party appealing the order] [was] free to object to consolidation.” *Id.* In effect, the *A.S.K. Plastics* order was designed to postpone consideration of the substantive consolidation issue until the plan confirmation stage.

That is not our case. For the Banks the District Court’s determination is hardly conditional. It concluded “that substantive consolidation should be permitted.” *In re Owens Corning*, 316 B.R. at 172. It made no provision for the Banks to reassert their objection to substantive consolidation at the plan confirmation stage; the order is final against them and is thus a practical termination of the substantive consolidation litigation.

Lastly, we address the Plan Proponents’ argument that a substantive consolidation order must immediately take effect

in order to be final for purposes of our jurisdiction. What they ignore is that the order approving substantive consolidation is the foundation on which the Plan is built. To assert that the actual substantive consolidation can only be implemented in conjunction with the effectiveness of an approved plan puts form over function. As the Banks point out, “[t]here is no support for the proposition that final orders lose their finality because of a delay in implementation.” CSFB Opp’n to Mot. to Dismiss at 13. Certainly, decisions resolving most disputes (notably, disputes over the validity and value of claims) are not implemented until a plan is confirmed and payment under the plan becomes obligatory. Yet we exercise jurisdiction to review many of these decisions before that “final” order issues. *See, e.g., Hesta v. Official Comm. of Unsecured Creditors (In re Am. Classic Voyages Co.)*, 405 F.3d 127 (3d Cir.2005). No reason exists for us to vary that routine here.

We conclude readily that we have appellate jurisdiction to consider the Banks’ appeal under 28 U.S.C. § 1291.

### III. Substantive Consolidation

Substantive consolidation, a construct of federal common law, emanates from equity. It “treats separate legal entities as if they were merged into a single survivor left with all the cumulative assets and liabilities (save for inter-entity liabilities, which are erased). The result is that claims of creditors against separate debtors morph to claims against the consolidated survivor.” *Genesis Health Ventures, Inc. v. Stapleton (In re Genesis Health Ventures, Inc.)*, 402 F.3d 416, 423 (3d Cir.2005). Consolidation restructures (and thus revalues) rights of creditors and for certain creditors this may result in significantly less recovery.

While we have not fully considered the character and scope of substantive consolidation, we discussed the concept in *Nesbit*, 347 F.3d at 86-88 (surveying substantive consolidation case law for application by analogy to the Title VII inquiry of when to consolidate employers for the purpose of assessing a discrimination claim), and *In re Genesis Health Ventures*, 402 F.3d at 423-24 (examining, *inter alia*, whether

a "deemed" consolidation for voting in connection with, and distribution under, a proposed plan of reorganization is a substantive consolidation for purposes of calculating U.S. Trustee quarterly fees under 28 U.S.C. § 1930(a)(6)). Other courts, including the Supreme Court itself in an opinion that spawned the concept of consolidation, have holdings more on point than heretofore have we. We begin with a survey of key cases, drawing from them when substantive consolidation may apply consistent with the principles we perceive as cabinining its use, and apply those principles to this case.

### A. History of Substantive Consolidation

The concept of substantively consolidating separate estates begins with a commonsense deduction. Corporate disregard<sup>10</sup> as a fault may lead to corporate disregard as a remedy.

Prior to substantive consolidation, other remedies for corporate disregard were (and remain) in place. For example, where a subsidiary is so dominated by its corporate parent as to be the parent's "alter ego," the "corporate veil" of the subsidiary can be ignored (or "pierced") under state law. Kors, *supra*, at 386-90 (citing as far back as I. Maurice Wormser, *Piercing the Veil of Corporate Entity*, 12 Colum. L.Rev. 496 (1912)). Or a court might mandate that the assets transferred to a corporate subsidiary be turned over to its parent's trustee in bankruptcy for wrongs such as fraudulent transfers. Kors, *supra*, at 391, in effect bringing back to the bankruptcy estate assets wrongfully conveyed to an affiliate. If a corporate parent is both a creditor of a subsidiary and so dominates the affairs of that entity as to prejudice unfairly its other creditors, a court may place payment priority to the parent below that of the other creditors, a remedy known as equitable subordination, which is now codified in § 510(c) of the Bankruptcy Code. See generally *id.* at 394-95.

Adding to these remedies, the Supreme Court, little more than six decades ago, approved (at least indirectly and per-

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<sup>10</sup> A term used by Mary Elisabeth Kors in her comprehensive and well-organized article entitled *Altered Egos: Deciphering Substantive Consolidation*, 59 U. Pitt. L.Rev. 381, 383 (1998) (hereinafter "Kors").

haps inadvertently) what became known as substantive consolidation.<sup>11</sup> *Sampsell v. Imperial Paper & Color Corp.*, 313 U.S. 215, 61 S.Ct. 904, 85 L.Ed. 1293 (1941). In *Sampsell* an individual in bankruptcy had transferred assets prepetition to a corporation he controlled. (Apparently these became the corporation's sole assets.) When the bankruptcy referee ordered that the transferred assets be turned over by the corporation to the individual debtor's trustee, a creditor of the non-debtor corporation sought distribution priority with respect to that entity's assets. In deciding that the creditor should not be accorded priority (thus affirming the bankruptcy referee), the Supreme Court turned a typical turnover/fraudulent transfer case into the forbear of today's substantive consolidation by terming the bankruptcy referee's order (marshaling the corporation's assets for the benefit of the debtor's estate) as "consolidating the estates." *Id.* at 219, 61 S.Ct. at 907.

Each of these remedies has subtle differences. "Piercing the corporate veil" makes shareholders liable for corporate wrongs. Equitable subordination places bad-acting creditors behind other creditors when distributions are made. Turnover and fraudulent transfer bring back to the transferor debtor assets improperly transferred to another (often an affiliate). Substantive consolidation goes in a direction different (and in most cases further) than any of these remedies; it is not limited to shareholders, it affects distribution to innocent creditors, and it mandates more than the return of specific assets to the predecessor owner. It brings all the assets of a group of entities into a single survivor. Indeed, it merges liabilities as well. "The result," to repeat, "is that claims of creditors against separate debtors morph to claims against the consolidated survivor." *In re Genesis Health Ventures*, 402 F.3d at 423. The bad news for certain creditors is that, instead of looking to assets of the subsidiary with whom they dealt, they now must share those assets with all creditors of

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<sup>11</sup> The actual term was not used until 1977. *In re Commercial Envelope Mfg. Co.*, 3 Bankr.Ct. Dec. 647, 648, 1977 WL 182366 (Bankr. S.D.N.Y.1977) (Babitt, J.).

all consolidated entities, raising the specter for some of a significant distribution diminution.

Though the concept of consolidating estates had Supreme Court approval, Courts of Appeal (with one exception) were slow to follow suit. *Stone v. Eacho (In re Tip Top Tailors, Inc.)*, 127 F.2d 284 (4th Cir.1942), *cert. denied*, 317 U.S. 635, 63 S.Ct. 54, 87 L.Ed. 512 (1942), was the first to pick up on *Sampsell's* new remedy.<sup>12</sup> Little occurred thereafter for more than two decades, until the Second Circuit issued several decisions – *Soviero v. National Bank of Long Island*, 328 F.2d 446 (2d Cir.1964); *Chemical Bank New York Trust Co. v. Kheel (In re Seatrade Corp.)*, 369 F.2d 845 (2d Cir.1966); *Flora Mir Candy Corp. v. R.S. Dickson & Co. (In re Flora Mir Candy Corp.)*, 432 F.2d 1060 (2d Cir.1970); and *Talcott v. Wharton (In re Continental Vending Machine Corp.)*, 517 F.2d 997 (2d Cir.1975) – that brought substantive consolidation as a remedy back into play and premise its modern-day understanding.

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<sup>12</sup> Another case oft-mentioned, and preceding both *Sampsell* and *Stone*, is *Fish v. East*, 114 F.2d 177 (10th Cir.1940). Determining that a corporate subsidiary was simply the parent's "instrumentality," *id.* at 191, the Tenth Circuit affirmed the turnover of the subsidiary's assets to the parent. Though asserting that a "corporate entity may be disregarded where not to do so will defeat public convenience, justify wrong or protect fraud," *id.*, "consolidation" was not mentioned. Indeed, as creditors of the subsidiary in *Fish* were given first priority as to its assets, *id.*, a complete consolidation did not occur. *Accord* *Kors, supra*, at 391 ("true consolidation" occurs only when creditors of consolidated entities share *pari passu*).

A case from our Court – *In re Pittsburgh Rys. Co.*, 155 F.2d 477 (3d Cir.1946), *cert. denied sub nom. Phila. Co. v. City of Pittsburgh*, 329 U.S. 731, 67 S.Ct. 90, 91 L.Ed. 632 (1946) – cited *Stone, id.* at 484-85 n. 15, in granting the request of the City of Pittsburgh to exercise bankruptcy jurisdiction over non-debtor companies controlled by the debtor Pittsburgh Railways Company. While guided by the practical need to "strip[ ] off" corporate "cloak[s]," *id.* at 484, in reorganizing Pittsburgh's transportation system, our Court pointed out that "[t]he reorganization court cannot indefinitely be called upon to provide . . . unification," *id.* at 481. In so doing, it emphasized that "we are in no way passing upon the fairness of any plan [of reorganization]." *Id.* at 485; *see also id.* at 481.

Other Circuit Courts fell in line in acknowledging substantive consolidation as a possible remedy. See, e.g., *FDIC v. Hogan (In re Gulfco Inv. Corp.)*, 593 F.2d 921, 927-28 (10th Cir.1979); *Pension Benefit Guar. Corp. v. Ouimet Corp.*, 711 F.2d 1085, 1092-93 (1st Cir.1983), cert. denied, 464 U.S. 961, 104 S.Ct. 393, 78 L.Ed.2d 337 (1983); *Drabkin v. Midland-Ross Corp. (In re Auto-Train Corp.)*, 810 F.2d 270, 276 (D.C.Cir.1987); *Eastgroup*, 935 F.2d at 248; *In re Giller*, 962 F.2d at 799; *First Nat'l Bank of Barnesville v. Rafoth (In re Baker & Getty Fin. Servs., Inc.)*, 974 F.2d 712, 720 (6th Cir.1992); *Reider v. FDIC (In re Reider)*, 31 F.3d 1102, 1105-07 (11th Cir.1994); and *In re Bonham*, 229 F.3d at 771.

The reasons of these courts for allowing substantive consolidation as a possible remedy span the spectrum and often overlap. For example, *Stone* and *Soviero* followed the well-trod path of alter ego analysis in state "pierce-the-corporate-veil" cases. *Stone*, 127 F.2d at 287-89; *Soviero*, 328 F.2d at 447-48. Accord *In re Gulfco Inv. Corp.*, 593 F.2d at 928-29. *Kheel* dealt with, *inter alia*, the net-negative practical effects of attempting to thread back the tangled affairs of entities, separate in name only, with "interrelationships . . . hopelessly obscured." 369 F.2d at 847. See also, e.g., *In re Augie/Restivo*, 860 F.2d at 518-19. *In re Continental Vending Machine* balanced the "inequities" involved when substantive rights are affected against the "practical considerations" spawned by "accounting difficulties (and expense) which may occur where the interrelationships of the corporate group are highly complex, or perhaps untraceable." 517 F.2d at 1001. See also, e.g., *In re Auto-Train*, 810 F.2d at 276; *Eastgroup*, 935 F.2d at 249; *In re Giller*, 962 F.2d at 799; *In re Reider*, 31 F.3d at 1107-08. See generally *Kors, supra*, at 402-06.

Ultimately most courts slipstreamed behind two rationales – those of the Second Circuit in *Augie/Restivo* and the D.C. Circuit in *Auto-Train*. The former found that the competing "considerations are merely variants on two critical factors: (i) whether creditors dealt with the entities as a single economic unit and did not rely on their separate identity in ex-

tending credit, . . . or (ii) whether the affairs of the debtors are so entangled that consolidation will benefit all creditors. . . ." *In re Augie/Restivo*, 860 F.2d at 518 (internal quotation marks and citations omitted). *Auto-Train* touched many of the same analytical bases as the prior Second Circuit cases, but in the end chose as its overarching test the "substantial identity" of the entities and made allowance for consolidation in spite of creditor reliance on separateness when "the demonstrated benefits of consolidation 'heavily' outweigh the harm." *In re Auto-Train*, 810 F.2d at 276 (citation omitted).

Whatever the rationale, courts have permitted substantive consolidation as an equitable remedy in certain circumstances.<sup>13</sup> No court has held that substantive consolidation is not authorized,<sup>14</sup> though there appears nearly unanimous con-

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<sup>13</sup> Indeed, they have not restricted the remedy to debtors, allowing the consolidation of debtors with non-debtors, *see, e.g., In re Bonham*, 229 F.3d at 765 (explaining that "[c]ourts have permitted the consolidation of non-debtor and debtor entities in furtherance of the equitable goals of substantive consolidation") (citing *In re Auto-Train*, 810 F.2d at 275; *In re Tureaud*, 59 B.R. 973, 974, 978 (N.D.Okla.1986); *In re Munford, Inc.*, 115 B.R. 390, 395-96 (Bankr.N.D.Ga.1990)); *Soviero*, 328 F.2d 446, and in some cases consolidation retroactively (known also as *nunc pro tunc* consolidation), *see, e.g., In re Bonham*, 229 F.3d at 769-71; *In re Baker & Getty Fin. Servs.*, 974 F.2d at 720-21; *Kroh Bros. Development Co. v. Kroh Bros. Management Co. (In re Kroh Bros. Development Co.)*, 117 B.R. 499, 502 (W.D.Mo.1989); *see also Auto-Train*, 810 F.2d at 277 (acknowledging that *nunc pro tunc* consolidations can occur, though not in that case).

In addition, though we do not permit the consolidation sought in this case, no reason exists to limit it under the right circumstances to any particular form of entity. (Indeed, this case involves corporations and limited liability companies.) *Accord 2 Collier on Bankruptcy* ¶ 105.09[1][c] (15th rev. ed.2005).

<sup>14</sup> *See In re Bonham*, 229 F.3d at 765 (explaining that "the equitable power [of substantive consolidation] undoubtedly survived enactment of the Bankruptcy Code" and noting that "[n]o case has held to the contrary"); *but see In re Fas Mart Convenience Stores, Inc.*, 320 B.R. 587, 594 n. 3 (Bankr.E.D.Va.2004) (noting "there is persuasive academic argument that there is no authority in bankruptcy law for substantive consolidation") (citing Daniel B. Bogart, *Resisting the Expansion of Bank-*

*ruptcy Court Power Under Section 105 of the Bankruptcy Code: The All Writs Act and an Admonition from Chief Justice Marshall*, 35 Ariz. St. L.J. 793, 810 (2003); J. Maxwell Tucker, *Grupo Mexicano and the Death of Substantive Consolidation*, 8 Am. Bankr.Inst. L.Rev. 427 (2000) (hereinafter "Tucker").

Since the Supreme Court's decision in *Grupo Mexicano de Desarrollo, S.A. v. Alliance Bond Fund, Inc.*, 527 U.S. 308, 119 S.Ct. 1961, 144 L.Ed.2d 319 (1999) (federal district courts lack the equitable power to enjoin prejudgment transfers of assets, as such an equitable remedy did not exist at the time federal courts were created under the Judiciary Act of 1789), some argue that substantive consolidation, judge-made law not expressly codified in the Bankruptcy Code adopted in the late 1970s, does not qualify as an available equitable remedy. See, e.g., Tucker, *supra* at 442-45. This argument has two facets. The first is that bankruptcy courts are limited to exercising only the equitable remedies extant at the time of the adoption of the Judiciary Act of 1789. As substantive consolidation is a relatively recent remedy nowhere contemplated in 1789, *Grupo Mexicano* by analogy bars substantive consolidation just as it does prejudgment preliminary injunctions forbidding asset transfers. *Id.* The second (and corollary) facet of the argument is that, as substantive consolidation is not specifically authorized in the Bankruptcy Code, authority to confer it can exist, if at all, only in § 105(a) of the Bankruptcy Code (bankruptcy courts "may issue any order, process or judgment that is necessary or appropriate to carry out the provisions of this title"). Even if § 105(a) "constitutes a direct, fresh grant of supplemental power to the bankruptcy courts, independent of the judicial power granted to the federal courts under title 28 [of the United States Code]," *id.* at 447, it can only implement powers already expressed in the provisions of the Bankruptcy Code. *Id.* at 447-48. See *In re Combustion Eng'g, Inc.*, 391 F.3d 190, 236 (3d Cir.2004) ("The general grant of equitable power contained in § 105(a) . . . must be exercised within the parameters of the Code itself."); *In re Kmart Corp.*, 359 F.3d 866, 871 (7th Cir.2004) ("[T]he power conferred by § 105 is one to implement rather than override."). But for joint spouse estates in Bankruptcy Code § 302, consolidation is permitted only in the context of a confirmed plan of reorganization and the requirements that entails. Tucker, *supra*, at 449 (citing to, *inter alia*, Bankruptcy Code § 1123(a)(5)(C)).

The first facet of the argument is, at the outset, premature. Consolidating estates (indeed, consolidating debtor and non-debtor entities) traces to the Supreme Court's *Sampson* decision in 1941. 313 U.S. at 219, 61 S.Ct. 907. What the Court has given as an equitable remedy remains until it alone removes it or Congress declares it removed as an option. See *In re Stone & Webster*, 286 B.R. at 540 (quoting *Official Comm. of Asbestos*

*Claimants v. G-I Holdings, Inc. (In re G-I Holdings, Inc.)*, Adv. No. 01-3065(RG) (Bankr.D.N.J. March 12, 2001) (Hearing Tr. at 71-2)).

In addition, at the core of *Grupo Mexicano* was the extent of general, unarticulated equity authority in the federal courts (which, the Court held, can only be justified by reference to 1789 equity authority). It was *not* a bankruptcy case. The extensive history of bankruptcy law and judicial precedent renders the issue of equity authority in the bankruptcy context different to such a degree as to make it different in kind. Notably, in the only two instances in which the word “bankruptcy” appears in Justice Scalia’s majority opinion in *Grupo Mexicano*, he uses the *existence* of court authority in the bankruptcy context as a reason to support the conclusion that the district court did not have the authority under generalized equity powers to implement the remedy it imposed. First, he pointed out that “[t]he law of fraudulent conveyances and bankruptcy was developed to prevent [the] conduct [at issue]; an equitable power to restrict a debtor’s use of his unencumbered property before judgment was not.” *Grupo Mexicano*, 527 U.S. at 322, 119 S.Ct. at 1970 (emphasis added). Second, he stressed that finding the authority to justify the District Court’s remedy in generalized equity power would “add[ ], through judicial fiat, a new and powerful weapon to the creditor’s arsenal[ ]; the new rule could radically alter the balance between debtor’s and creditor’s rights which has been developed over centuries through many laws—including those relating to bankruptcy, fraudulent conveyances, and preferences.” *Id.* at 331, 119 S.Ct. at 1974 (emphasis added).

In short, the Court’s opinion in *Grupo Mexicano* acknowledged that bankruptcy courts do have the authority to deal with the problems presented by that case. One way to conceptualize this idea is to recognize that, had the company in *Grupo Mexicano* been in bankruptcy, the bankruptcy court would have had the authority to implement the remedy the district court lacked authority to order under general equity power outside the bankruptcy context.

As for the argument’s second facet, it begins with a concession. Bankruptcy Code § 1123(a)(5)(C)’s very words allow for “consolidation of the debtor with one or more persons” pursuant to a plan “[n]otwithstanding any otherwise applicable non-bankruptcy law.” *Accord* Tucker, *supra*, at 448-49. *See also In re Stone & Webster*, 286 B.R. at 540-43. Whether § 105(a) allows consolidation outside a plan is an issue we need not address – though that arguably is what the Plan Proponents propose by moving for a “deemed” consolidation – because, as we note below, consolidation, no matter how it is packaged, cannot pass muster in this case.

In this context, we also need not address the argument, made in the *Amicus Curiae* Brief of the Commercial Finance Association, that substantive consolidation fails the “best interests test” of Bankruptcy Code

sensus that it is a remedy to be used "sparingly." *In re Augie/Restivo*, 860 F.2d at 518; see also *In re Bonham*, 229 F.3d at 767 (explaining that "almost every other court has noted [that substantive consolidation] should be used 'sparingly'" (citing *In re Flora Mir*, 432 F.2d at 1062-63)).<sup>15</sup>

## B. Our View of Substantive Consolidation

Substantive consolidation exists as an equitable remedy. But when should it be available and by what test should its use be measured? As already noted, we have commented on substantive consolidation only generally in *Nesbit*, 347 F.3d at 86-88, and *In re Genesis Health Ventures*, 402 F.3d at 423-24. The latter nonetheless left little doubt that, if presented with a choice of analytical avenues, we favor essentially that of *Augie/Restivo*. *Id.* at 423. The *Auto-Train* approach (requiring "substantial identity" of entities to be consolidated, plus that consolidation is "necessary to avoid some harm or realize some benefit," 810 F.2d at 276) adopts, we presume, one of the *Augie/Restivo* touchstones for substantive consolidation while adding the low bar of avoiding some harm or discerning some benefit by consolidation. To us this fails to capture completely the few times substantive consolidation may be considered and then, when it does hit one chord, it allows a threshold not sufficiently egregious and too imprecise for easy measure. For example, we disagree that "[i]f a creditor makes [a showing of reliance on separateness], the court may order consolidation . . . if it determines that the demonstrated benefits of consolidation 'heavily' outweigh the harm." *Id.* at 276 (citation omitted); see also *Eastgroup*,

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§ 1129(a)(7) (a requirement for plan confirmation that each creditor that does not vote to accept the plan must receive or retain property under the plan at least equal to its recovery in a Bankruptcy Code Chapter 7 liquidation). See generally *In re Stone & Webster*, 286 B.R. at 544-46.

<sup>15</sup> Thus we disagree with the assertion of a "liberal trend" toward increased use of substantive consolidation - e.g., *Eastgroup*, 935 F.2d at 248 (describing "a 'modern' or 'liberal' trend toward allowing substantive consolidation") (citing *In re Murray Indus., Inc.*, 119 B.R. 820, 828 (Bankr.M.D.Fla.1990); *In re Veeco Constr. Indus., Inc.*, 4 B.R. 407, 409 (Bankr.E.D.Va.1980)).

935 F.2d at 249. If an objecting creditor relied on the separateness of the entities, consolidation cannot be justified *vis-à-vis* the claims of that creditor.<sup>16</sup>

In assessing whether to order substantive consolidation, courts consider many factors (some of which are noted in *Nesbit*, 347 F.3d at 86-88 nn. 7 & 9). They vary (with degrees of overlap) from court to court. Rather than endorsing any prefixed factors, in *Nesbit* we “adopt[ed] an intentionally open-ended, equitable inquiry . . . to determine when substantively to consolidate two entities.” *Id.* at 87. While we mentioned that “in the bankruptcy context the inquiry focuses primarily on financial entanglement,” *id.*, this comment primarily related to the hopeless commingling test of substantive consolidation. But when creditors deal with entities as an indivisible, single party, “the line between operational and financial [factors] may be blurred.” *Id.* at 88. We reiterate that belief here. Too often the factors in a checklist fail to separate the unimportant from the important, or even to set out a standard to make the attempt. *Accord* Br. of Law Professors<sup>17</sup> as *Amici Curiae* at 11-12. This often results in rote following of a form containing factors where courts tally up and spit out a score without an eye on the principles that give

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<sup>16</sup> This opens the question whether a court can order partial consolidation (such a consolidation order “could provide that . . . [a creditor relying on separateness] would receive a distribution equal to what [it] would have received absent consolidation and that the remainder of the assets and liabilities be consolidated.”). Kors, *supra*, at 450- 51. Because this theoretical issue is not before us – and in any event (i) facts bringing it to the fore are unlikely, *id.* at 451 (“If circumstances lead one party to rely on the single status of the one debtor, it is unlikely that other creditors are relying on the joint status of the two entities, especially as reliance must be reasonable.”), and (ii) may present practical concerns depending on the facts of a particular case – we do not decide it in this case.

<sup>17</sup> They are Robert K. Rasmussen of Vanderbilt Law School, Barry Adler of the NYU School of Law, Susan Block-Leib of Fordham University School of Law, G. Marcus Cole of Stanford Law School, Marcel Kahan of the NYU School of Law, Ronald J. Mann of the University of Texas Law School, and David A. Skeel, Jr. of the University of Pennsylvania School of Law.

the rationale for substantive consolidation (and why, as a result, it should so seldom be in play). *Id.* ("Differing tests with a myriad of factors run the risk that courts will miss the forest for the trees. Running down factors as a check list can lead a court to lose sight of why we have substantive consolidation in the first instance . . . and often [to] fail [to] identify a metric by which [it] can . . . [assess] the relative importance among the factors. The . . . [result is] resort to ad hoc balancing without a steady eye on the . . . [principles] to be advanced. . .").

What, then, are those principles? We perceive them to be as follows.

- (1) Limiting the cross-creep of liability by respecting entity separateness is a "fundamental ground rule[]." Kors, *supra*, at 410. As a result, the general expectation of state law and of the Bankruptcy Code, and thus of commercial markets, is that courts respect entity separateness absent compelling circumstances calling equity (and even then only possibly substantive consolidation) into play.
- (2) The harms substantive consolidation addresses are nearly always those caused by *debtors* (and entities they control) who disregard separateness.<sup>18</sup> Harms caused by creditors typically are remedied by provisions found in the Bankruptcy Code (*e.g.*, fraudulent transfers, §§ 548 and 544(b)(1), and equitable subordination, § 510(c)).
- (3) Mere benefit to the administration of the case (for example, allowing a court to simplify a case by avoiding other issues or to make postpetition accounting more convenient) is hardly a harm calling substantive consolidation into play.

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<sup>18</sup> Though creditors conceivably can cause debtors to conflate separate organizational forms, the specter of lender liability (which came to the fore in only the last two decades) makes this theoretical possibility all the more remote.

- (4) Indeed, because substantive consolidation is extreme (it may affect profoundly creditors' rights and recoveries) and imprecise, this "rough justice" remedy should be rare and, in any event, one of last resort after considering and rejecting other remedies (for example, the possibility of more precise remedies conferred by the Bankruptcy Code).
- (5) While substantive consolidation may be used defensively to remedy the identifiable harms caused by entangled affairs, it may not be used offensively (for example, having a primary purpose to disadvantage tactically a group of creditors in the plan process or to alter creditor rights).

The upshot is this. In our Court what must be proven (absent consent) concerning the entities for whom substantive consolidation is sought is that (i) prepetition they disregarded separateness so significantly their creditors relied on the breakdown of entity borders and treated them as one legal entity,<sup>19</sup> or (ii) postpetition their assets and liabilities are so scrambled that separating them is prohibitive and hurts all creditors.<sup>20</sup>

Proponents of substantive consolidation have the burden of showing one or the other rationale for consolidation. The

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<sup>19</sup> This rationale is meant to protect in bankruptcy the prepetition expectations of those creditors. *Accord* Kors, *supra*, at 419. The usual scenario is that creditors have been misled by debtors' actions (regardless whether those actions were intentional or inadvertent) and thus perceived incorrectly (and relied on this perception) that multiple entities were one.

<sup>20</sup> This rationale is at bottom one of practicality when the entities' assets and liabilities have been "hopelessly commingled." *In re Gulfco Inv. Corp.*, 593 F.2d at 929; *In re Veeco Constr. Indus.*, 4 B.R. at 410. Without substantive consolidation all creditors will be worse off (as Humpty Dumpty cannot be reassembled or, even if so, the effort will threaten to reprise *Jarndyce and Jarndyce*, the fictional suit in Dickens' *Bleak House* where only the professionals profited). With substantive consolidation the lot of all creditors will be improved, as consolidation "advance[s] one of the primary goals of bankruptcy — enhancing the value of the assets available to creditors . . . — often in a very material respect." Kors, *supra*, at 417 (citation omitted).

second rationale needs no explanation. The first, however, is more nuanced. A *prima facie* case for it typically exists when, based on the parties' prepetition dealings, a proponent proves corporate disregard creating contractual expectations of creditors<sup>21</sup> that they were dealing with debtors as one indistinguishable entity. Kors, *supra*, at 417-18; Christopher W. Frost, *Organizational Form, Misappropriation Risk, and the Substantive Consolidation of Corporate Groups*, 44 Hastings L.J. 449, 457 (1993). Proponents who are creditors must also show that, in their prepetition course of dealing, they actually and reasonably relied on debtors' supposed unity. Kors, *supra*, at 418-19. Creditor opponents of consolidation can nonetheless defeat a *prima facie* showing under the first rationale if they can prove they are adversely affected and actually relied on debtors' separate existence.<sup>22</sup>

### C. Application of Substantive Consolidation to Our Case

With the principles we perceive underlie use of substantive consolidation, the outcome of this appeal is apparent at the outset. Substantive consolidation fails to fit the facts of our case and, in any event, a "deemed" consolidation cuts against the grain of all the principles.

To begin, the Banks did the "deal world" equivalent of "Lending 101." They loaned \$2 billion to OCD and enhanced the credit of that unsecured loan indirectly by subsidiary guarantees covering less than half the initial debt. What the Banks got in lending lingo was "structural seniority" – a direct claim against the guarantors (and thus against their assets levied on once a judgment is obtained) that other creditors of OCD did not have. This kind of lending occurs

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<sup>21</sup> "[T]ort and statutory claimants, who, as involuntary creditors, by definition did not rely on anything in becoming creditors." Kors, *supra*, at 418, are excluded, leaving only those creditors who contract with an entity for whom consolidation is sought.

<sup>22</sup> As noted already, *supra* n. 16, we do not decide here whether such a showing by an opposing creditor defeats totally the quest for consolidation or merely consolidation as to that creditor.

every business day. To undo this bargain is a demanding task.

1. NO PREPETITION DISREGARD OF CORPORATE SEPARATENESS

Despite the Plan Proponents' pleas to the contrary, there is no evidence of the prepetition disregard of the OCD entities' separateness. To the contrary, OCD (no less than CSFB) negotiated the 1997 lending transaction premised on the separateness of all OCD affiliates. Even today no allegation exists of bad faith by anyone concerning the loan.<sup>23</sup> In this context, OCD and the other Plan Proponents cannot now ignore, or have us ignore, the very ground rules OCD put in place. Playing by these rules means that obtaining the guarantees of separate entities, made separate by OCD's choice of how to structure the affairs of its affiliate group of companies, entitles a lender, in bankruptcy or out, to look to any (or all) guarantor(s) for payment when the time comes. As such, the District Court's conclusions of "substantial identity" of OCD and its subsidiaries, and the Banks' reliance thereon, are incorrect. For example, testimony presented by both the Banks and the Debtors makes plain the parties' intention to treat the entities separately. CSFB presented testimony from attorneys and bankers involved in negotiating the Credit Agreement that reflected their assessment of the value of the guarantees as partially derived from the separateness of the entities. As OCD concedes, these representatives "testified that the guarant[e]es were . . . intended to provide 'structural seniority' to the banks," and were thus fundamentally premised on an assumption of separateness. Debtors Ans. Br. at 26.

In the face of this testimony, Plan Proponents nonetheless argue that the Banks intended to ignore the separateness of the entities. In support of this contention, they assert, *inter alia*, that because the Banks did not receive independent financial statements for each of the entities during the negotiat-

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<sup>23</sup> The bondholders do claim certain Banks misled them in purchasing OCD debt subsequent to the 1997 loan. But we know of no claim of wrong by the Banks in connection with the 1997 transaction.

ing process, they must have intended to deal with them as a unified whole. Because the Banks were unaware of the separate financial makeup of the subsidiaries, the argument goes, they could not have relied on their separateness.<sup>24</sup>

This argument is overly simplistic. Assuming the Banks did not obtain separate financial statements for each subsidiary, they nonetheless obtained detailed information about each subsidiary guarantor from OCD, including information about that subsidiary's assets and debt. Moreover, the Banks knew a great deal about these subsidiaries. For example, they knew that each subsidiary guarantor had assets with a book value of at least \$30 million as per the terms of the Credit Agreement, that the aggregate value of the guarantor subsidiaries was over \$900 million and that those subsidiaries had little or no debt. Additionally, the Banks knew that Fibreboard's subsidiaries (including the entities that became part of ESI) had no asbestos liability, would be debt-free post-acquisition and had assets of approximately \$700 million.

Even assuming the Plan Proponents could prove perpetuation disregard of Debtors' corporate forms, we cannot conceive of a justification for imposing the rule that a creditor

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<sup>24</sup> Debtors make a similar argument on the basis of the Banks' failure to exercise their right to monitor the entities independently. For much the same reasoning that follows in the text, we reject that argument as well.

We reject outright Debtors' claim that the Banks' alleged reliance on corporate separateness fails because they did not obtain a third-party legal opinion from counsel that substantive consolidation was unlikely to occur were OCD or the guarantors subject to bankruptcy. By custom and practice this type of counsel opinion is requested and given for newly formed entities whose "special purpose" is to obtain structured financing (*i.e.*, where "a defined group of assets . . . [are] structurally isolated, and thus serve as the basis of a financing. . . ." Committee on Bankruptcy and Corporate Reorganization of The Association of the Bar of the City of New York, *Structured Financing Techniques*, 50 Bus. Law. 527, 529 (1995)). It is customarily not given (nor even requested) for entities in existence for any significant period of time or set up for other than a structured financing transaction. See Tribar Opinion Committee, *Opinions in the Bankruptcy Context: Rating Agency, Structured Financing, and Chapter 11 Transactions*, 46 Bus. Law. 717, 726 & n. 42 (1991).

must obtain financial statements from a debtor in order to rely reasonably on the separateness of that debtor. Creditors are free to employ whatever metrics they believe appropriate in deciding whether to extend credit free of court oversight. We agree with the Banks that “the reliance inquiry is not an inquiry into lenders’ internal credit metrics. Rather, it is about the *fact* that the credit decision was made in reliance on the existence of separate entities. . . .” CSFB Opening Br. at 31 (emphasis in original).<sup>25</sup> Here there is no serious dispute as to that fact.

## 2. NO HOPELESS COMMINGLING EXISTS POSTPETITION

There also is no meaningful evidence postpetition of hopeless commingling of Debtors’ assets and liabilities. Indeed, there is no question which entity owns which principal assets and has which material liabilities. Likely for this reason little time is spent by the parties on this alternative test for substantive consolidation. It is similarly likely that the District Court followed suit.

The Court nonetheless erred in concluding that the commingling of assets will justify consolidation when “the affairs of the two companies are so entangled that consolidation *will be beneficial*.” *In re Owens Corning*, 316 B.R. at 171 (emphasis added). As we have explained, commingling justifies consolidation only when separately accounting for the assets and liabilities of the distinct entities will reduce the recovery of *every* creditor – that is, when every creditor will benefit from the consolidation. Moreover, the benefit to creditors should be from cost savings that make assets available rather than from the shifting of assets to benefit one group of creditors at the expense of another. Mere benefit to some creditors, or administrative benefit to the Court, falls far short. The District Court’s test not only fails to adhere to the theoretical justification for “hopeless commingling” consolidation – that no creditor’s rights will be impaired – but also suffers from the infirmity that it will almost always be met. That is,

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<sup>25</sup> Further, a creditor’s lack of diligence is relevant only insofar as it bears on the credibility of its assertion of reliance on separateness.

substantive consolidation will nearly always produce some benefit to some in the form of simplification and/or avoidance of costs. Among other things, following such a path misapprehends the degree of harm required to order substantive consolidation.

But no matter the legal test, a case for hopeless commingling cannot be made. Arguing nonetheless to the contrary, Debtors assert that "it would be practically impossible and prohibitively expensive in time and resources" to account for the voluntary bankruptcies of the separate entities OCD has created and maintained. Debtors Ans. Br. at 63. In support of this contention, Debtors rely almost exclusively on the District Court's findings that

it would be exceedingly difficult to untangle the financial affairs of the various entities . . . [and] there are . . . many reasons for challenging the accuracy of the results achieved [in accounting efforts thus far]. For example, transfers of cash between subsidiaries and parent did not include any payment of interest; and calculations of royalties are subject to question.

*In re Owens Corning*, 316 B.R. at 171. Assuming *arguendo* that these findings are correct, they are simply not enough to establish that substantive consolidation is warranted.

Neither the impossibility of perfection in untangling the affairs of the entities nor the likelihood of some inaccuracies in efforts to do so is sufficient to justify consolidation. We find *R 2 Investments, LDC v. World Access, Inc. (In re World Access, Inc.)*, 301 B.R. 217 (Bankr.N.D.Ill. 2003), instructive on this point. In *World Access* the Court noted that the controlling entity "had no uniform guidelines for the recording of intercompany interest charges" and that the debtors failed to "allocate overhead charges amongst themselves." *Id.* at 234. The Court held, however, that those accounting shortcomings were "merely imperfections in a sophisticated system of accounting records that were conscientiously maintained." *Id.* at 279. It ultimately concluded that "all the relevant accounting data . . . still exist[ed]," that only a "reasonable review to

make any necessary adjustments [was] required," and, thus, that substantive consolidation was not warranted. *Id.*

The record in our case compels the same conclusion. At its core, Debtors' argument amounts to the contention that because intercompany interest and royalty payments were not perfectly accounted for, untangling the finances of those entities is a hopeless endeavor. Yet imperfection in intercompany accounting is assuredly not atypical in large, complex company structures. For obvious reasons, we are loathe to entertain the argument that complex corporate families should have an expanded substantive consolidation option in bankruptcy. And we find no reason to doubt that "perfection is not the standard in the substantive consolidation context." *Id.* We are confident that a court could properly order and oversee an accounting process that would sufficiently account for the interest and royalty payments owed among the OCD group of companies for purposes of evaluating intercompany claims – dealing with inaccuracies and difficulties as they arise and not in hypothetical abstractions.

On the basis of the record before us, the Plan Proponents cannot fulfill their burden of demonstrating that Debtors' affairs are even tangled, let alone that the cost of untangling them is so high relative to their assets that the Banks, among other creditors, will benefit from a consolidation.<sup>26</sup>

### 3. OTHER CONSIDERATIONS DOOM CONSOLIDATION AS WELL

Other considerations drawn from the principles we set out also counsel strongly against consolidation. First of all, holding out the possibility of later giving priority to the Banks on their claims does not cure an improvident grant of substantive consolidation. Among other things, the prerequisites for this last-resort remedy must still be met no matter the priority of the Banks' claims.

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<sup>26</sup> For example, we simply cannot imagine that it would cost Debtors even 1% of the Banks' asserted \$1.6 billion claim to account for the allegedly incalculable intercompany interest and royalty payments.

Secondly, substantive consolidation should be used defensively to remedy identifiable harms, not offensively to achieve advantage over one group in the plan negotiation process (for example, by deeming assets redistributed to negate plan voting rights), nor a "free pass" to spare Debtors or any other group from proving challenges, like fraudulent transfer claims, that are liberally brandished to scare yet are hard to show. If the Banks are so vulnerable to the fraudulent transfer challenges Debtors have teed up (but have not swung at for so long), then the game should be played to the finish in that arena.<sup>27</sup>

But perhaps the flaw most fatal to the Plan Proponents' proposal is that the consolidation sought was "deemed" (*i.e.*, a pretend consolidation for all but the Banks). If Debtors' corporate and financial structure was such a sham before the filing of the motion to consolidate, then how is it that post the Plan's effective date this structure stays largely undisturbed, with the Debtors reaping all the liability-limiting, tax and regulatory benefits achieved by forming subsidiaries in the first place? In effect, the Plan Proponents seek to remake substantive consolidation not as a remedy, but rather a stragem to "deem" separate resources reallocated to OCD to strip the Banks of rights under the Bankruptcy Code, favor other creditors, and yet trump possible Plan objections by the Banks. Such "deemed" schemes we deem not Hoyle.

#### IV. Conclusion

Substantive consolidation at its core is equity. Its exercise must lead to an equitable result. "Communizing" assets of affiliated companies to one survivor to feed all creditors of all companies may to some be equal (and hence equitable). But it is hardly so for those creditors who have lawfully bargained perpetition for unequal treatment by obtaining guaran-

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<sup>27</sup> The same sentiment applies to the argument of the bondholders that, subsequent to the 1997 loan to OCD, the Banks defrauded them in connection with a prospectus distributed with respect to a sale of OCD bonds underwritten by some of the Banks. If the bondholders have a valid claim, they need to prove it in the District Court and not use their allegations as means to gerrymander consolidation of estates.

tees of separate entities. *Accord Kheel*, 369 F.2d at 848 (Friendly, J., concurring) ("Equality among creditors who have lawfully bargained for different treatment is not equity but its opposite. . ."). No principled, or even plausible, reason exists to undo OCD's and the Banks' arms-length negotiation and lending arrangement, especially when to do so punishes the very parties that conferred the prepetition benefit – a \$2 billion loan unsecured by OCD and guaranteed by others only in part. To overturn this bargain, set in place by OCD's own pre-loan choices of organizational form, would cause chaos in the marketplace, as it would make this case the Banquo's ghost of bankruptcy.

With no meaningful evidence supporting either test to apply substantive consolidation, there is simply not the nearly "perfect storm" needed to invoke it. Even if there were, a "deemed" consolidation – "several zip (if not area) codes away from anything resembling substantive consolidation," *In re Genesis Health Ventures*, 402 F.3d at 424 – fails even to qualify for consideration. Moreover, it is here a tactic used as a sword and not a shield.

We thus reverse and remand this case to the District Court.

UNITED STATES BANKRUPTCY COURT  
FOR THE DISTRICT OF DELAWARE

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Nos. 00-3837 to 00-3854 (JPF)

IN RE OWENS CORNING, ET AL.,  
*Debtors.*

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Oct. 5, 2004

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**MEMORANDUM AND ORDER CONCERNING  
SUBSTANTIVE CONSOLIDATION**

FULLAM, Senior District Judge.

The Debtors, joined by most of the creditor groups, have presented and prosecuted a motion for substantive consolidation – *i.e.*, a request that the assets of, and claims against, the Debtors and all subsidiaries and affiliated entities be consolidated and treated as a single unit in these bankruptcy proceedings. A consortium of banks represented by Credit Suisse First Boston strenuously opposes such consolidation. A four-day evidentiary hearing on this issue was held by my predecessor, Judge Wolin, in May, 2003. I have read the transcript of the testimony, and have reviewed the voluminous documentary record compiled in the course of the hearing, and have had the benefit of post-trial briefing and argument. I am now prepared to set forth my views on the subject.

**I. Background**

Owens Corning and 17 of its wholly-owned subsidiaries jointly filed petitions for chapter 11 reorganization on October 5, 2000, and their respective bankruptcy proceedings have, in effect, been procedurally consolidated and are being jointly administered. All of the chapter 11 petitioners and their affiliated entities continue to carry on business as debtors-in-possession. The principal litigants in this litigation include, in addition to the Debtors, the bank consortium

represented by Credit Suisse First Boston; the Official Committee of Unsecured Creditors; a second committee or subcommittee of unsecured creditors representing the bondholders and trade creditors; Kensington International, Springfield Associates and Angelo Gordon and Company; the Official Committee of Asbestos Claimants; the Legal Representative for Future Claimants; and various individual asbestos claimants. To achieve an acceptable plan of reorganization, it will be necessary (1) to determine the value of the Debtors; (2) to determine the correct amounts of existing creditors' claims, and a reasonable estimate of future claims; (3) and to determine the correct allocation of values to be distributed to the various creditors. The absolute priority rule governs: no junior creditor may be paid unless senior creditors are paid in full, and all creditors in the same priority class must be treated alike.

## II. Discussion

The claim of the banks represented by Credit Suisse (hereinafter "the Banks") is for the unpaid balance of a series of loans made to Owens Corning and various of its subsidiaries pursuant to a credit agreement dated as of June 26, 1997, in which the Banks committed to lending a total of more than \$2 billion to Owens Corning and five of its subsidiaries. Forty-three Banks made commitments in varying amounts ranging from \$10 million to \$100 million, and made those amounts available for revolving loans, competitive advance loans, swing line loans and letter of credit commitments which could be drawn upon from time to time by the borrowers.

The parent company, Owens Corning of Delaware (OCD), guaranteed the repayment of all loans made pursuant to the credit agreement, whether to itself or any subsidiary; and each major subsidiary (those with assets having a book value of \$30 million or more) also guaranteed the repayment of all loans made pursuant to the credit agreement. It is this feature of cross-guarantees which the Banks rely upon as establishing that their claim, which, when the petition was filed, amounted to approximately \$1.6 billion, is superior to the

claims of all other creditors because it constitutes a direct claim against the parent company and each of the subsidiary guarantors, whereas the other creditors have direct claims against the parent company but only indirect claims against the subsidiaries, based upon the parent company's ownership of 100% of their stock. The Banks argue that, because of these differences, the Banks would be treated unfairly if substantive consolidation were to occur.

The question of when substantive consolidation is permissible has been the subject of much litigation, as well as learned discussion. At the hearing before Judge Wolin, all parties seemed to agree that the proper standard is that adopted by the D.C. Circuit in *Drabkin v. Midland-Ross Corp. (In re Auto-Train Corp., Inc.)*, 810 F.2d 270 (D.C. Cir.1987), and by the Eleventh Circuit in *Eastgroup Properties v. Southern Motel Assoc., Ltd.*, 935 F.2d 245 (11th Cir. 1991). More recently, the Third Circuit Court of Appeals has addressed the question, in *Nesbit v. Gears Unlimited, Inc.*, 347 F.3d 72 (3rd Cir.2003), *cert denied*, --- U.S. ----, 124 S.Ct. 1714, 158 L.Ed.2d 400 (2004).

Although the actual question presented in the *Nesbit* case was whether two separate corporations should be regarded as a single employer for purposes of determining the applicability of Title VII, the Third Circuit expressly adopted, as part of the test for that determination, the "factors Courts use in deciding whether substantively to consolidate two or more entities in the bankruptcy context." The Court added:

"While these factors vary from circuit to circuit, the test at base seeks to determine whether two or more entities' affairs are so interconnected that they collectively cause the alleged discriminatory employment practice. More colloquially, the question is whether the 'eggs' – consisting of the ostensibly separate companies – are so scrambled that we decline to unscramble them. We note, however, that substantive consolidation is an equitable remedy and is difficult to achieve."

As noted by the *Nesbit* Court, the Second Circuit Court of Appeals, in *In re Augie/Restivo Baking Co.*, 860 F.2d 515 (2d Cir.1988), has summarized the requirements set forth in the reported decisions as establishing two fundamental principles: (1) whether creditors dealt with the entities as a single economic unit and did not rely on their separate identity in extending credit, and (2) whether the affairs of the two companies are so entangled that consolidation will be beneficial. The Ninth Circuit has also adopted this formulation. See *In re Bonham*, 229 F.3d 750, 766 (9th Cir.2000).

The D.C. Circuit in the *Auto-Train* case, and the Eleventh Circuit in *Eastgroup Properties*, have taken the position that if the proponents of consolidation establish (1) that there is substantial identity between the entities to be consolidated, and (2) that consolidation is necessary to avoid some harm or to realize some benefits, a *prima facie* case for consolidation has been established, and the burden would then shift to the objecting creditor, to show (1) that it relied on the separate credit of one of the entities to be consolidated, and (2) that it will be prejudiced by substantive consolidation.

I have no difficulty in concluding that there is indeed substantial identity between the parent debtor OCD and its wholly-owned subsidiaries. All of the subsidiaries were controlled by a single committee, from central headquarters, without regard to the subsidiary structure. Control was exercised on a product-line basis. For example, the president of the insulating systems business managed all aspects of the production, marketing, and distribution of insulation products, regardless of whether those products were manufactured in a factory owned by OCD or by a foreign subsidiary. The officers and directors of the subsidiaries did not establish business plans or budgets, and did not appoint senior management except at the direction of the central committee (the "Natural Leadership Team"). Subsidiaries were established for the convenience of the parent company, primarily for tax reasons. All of the subsidiaries were dependent upon the parent company for funding and capital. The financial management of the entire enterprise was conducted in an inte-

grated manner. No subsidiary exercised control over its own finances.

It is also clear that substantive consolidation would greatly simplify and expedite the successful completion of this entire bankruptcy proceeding. More importantly, it would be exceedingly difficult to untangle the financial affairs of the various entities. While it is true that, as stressed by the Banks, the Debtors have apparently expended large sums of money having accounting experts attempt to sort out, and balance, the financial affairs of each entity, there are still many reasons for challenging the accuracy of the results achieved. For example, transfers of cash between subsidiaries and parent did not include any payment of interest; and calculations of royalties are subject to question.

I conclude, therefore, that the proponents of substantive consolidation have established a *prima facie* case. The next question is whether the Banks have proved that they relied upon the separate credit of the subsidiaries.

There can be no doubt that the Banks relied upon the overall credit of the entire Owens Corning enterprise. Each Bank's commitment was to the entire enterprise. The decision as to whether funds would be borrowed by the parent company, or by one or more of the subsidiaries, was made by the borrowers, not by the lenders. All of Owens Corning's financial reporting was done on a consolidated basis, and only that consolidated information was provided to the Banks.

It is also important to note that, in seeking and obtaining guarantees from the "substantial" subsidiaries, the Banks knew only that each guarantor had assets with a book value of \$30 million or more; the Banks had no information about the debts of such subsidiaries.

In short, there is simply no basis for a finding that, in extending credit, the Banks relied upon the separate credit of any of the subsidiary guarantors. This is not to say that the guarantees were not important to the Banks. The guarantees greatly simplified the administration of the Credit Agreement, and protected the Banks from having their claim sub-

ordinated to subsequent indebtedness of the subsidiary guarantors.

But the very existence of these cross-guarantees is a further reason for approving substantive consolidation. Any guarantor held liable on its guarantee would have a right of indemnification against whichever entity or entities borrowed the money. It would be extremely difficult to sort out the inter-subsidiary claims.

Moreover, the Banks' claims against the subsidiary guarantors are not clear-cut: each subsidiary guarantee is enforceable only to the extent that enforcement would not give rise to a claim that a voidable transfer was being carried out.

For these reasons, I believe it is unrealistic to suppose that the Banks would have an easier time collecting their claims if consolidation were denied.

It should be noted that, in October 2002, the Debtors and various creditor groups instituted an adversary proceeding against the Banks seeking to invalidate the subsidiary guarantees as constituting fraudulent conveyances. That action has been stayed pending resolution of the substantive consolidation issue. Apparently, it was felt that there would be no need to resolve the fraudulent conveyance action unless substantive consolidation were denied. Whether that assessment is correct need not be addressed at this time.

### III. Conclusions

I have concluded that substantive consolidation should be permitted, not only because of its obvious advantages – indeed, because it is a virtual necessity – but also because I see no reason why the Banks' claim cannot be appropriately dealt with in a consolidated plan of reorganization. The real issue is whether the Banks are entitled to participate, *pari passu*, with other unsecured creditors, or whether the Banks' claim is entitled to priority, in whole or in part, over the claims of other unsecured creditors. On the basis of the present record, I am not convinced that this is necessarily an all or nothing issue. That is, in the course of the plan-approval proceedings, the parties may come to a realization that the existence of the subsidiary guarantees does not warrant treating the

Banks as if their claim was secured, and thus superior to the claims of all other unsecured creditors; but that the existence of the subsidiary guarantees might warrant treating the Banks' claim as if it were partially secured. Whether such a resolution would be fair and equitable to all cannot now be determined.

It does seem to me rather obvious that the interests of *all* parties would best be served by the prompt achievement of a reasonably acceptable plan of reorganization; that litigating every conceivable issue to finality would be unduly expensive; and that the parties would be well-advised to settle their differences.

UNITED STATES COURT OF APPEALS  
FOR THE THIRD CIRCUIT

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No. 04-4080

IN RE: OWENS CORNING, A DELAWARE CORPORATION

CREDIT SUISSE FIRST BOSTON, AS AGENT FOR  
THE PREPETITION BANK LENDERS,  
*Appellant,*

---

**Present:** SCIRICA, *Chief Judge*, SLOVITER, ROTH,  
McKEE, AMBRO, FUENTES, SMITH, and FISHER,  
*Circuit Judges.*

---

**SUR PETITION FOR PANEL REHEARING  
WITH SUGGESTION FOR REHEARING EN BANC**

---

The petitions for rehearing filed by Appellees – Official Representative of the Bondholders and Trade Creditors, and James J. McMonagle, the Legal Representative for the Future Claimants and the Official Committee of Asbestos Claimants – having been submitted to the judges who participated in the decision of this Court, and to all the other available circuit judges in active service, and no judge who concurred in the decision having asked for rehearing, and a majority of the circuit judges of the Circuit in regular active service not having voted for rehearing by the Court en banc, the petition for rehearing is DENIED.

By the Court,

/s/ Thomas L. Ambro, Circuit Judge

Dated: September 28, 2005

nmb/cc: All counsel of record

## STATUTORY PROVISIONS INVOLVED

Section 105 of the Bankruptcy Code, 11 U.S.C. § 105, provides:

### § 105. Power of court.

(a) The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title. No provision of this title providing for the raising of an issue by a party in interest shall be construed to preclude the court from, *sua sponte*, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process.

(b) Notwithstanding subsection (a) of this section, a court may not appoint a receiver in a case under this title.

(c) The ability of any district judge or other officer or employee of a district court to exercise any of the authority or responsibilities conferred upon the court under this title shall be determined by reference to the provisions relating to such judge, officer, or employee set forth in title 28. This subsection shall not be interpreted to exclude bankruptcy judges and other officers or employees appointed pursuant to chapter 6 of title 28 from its operation.

(d) The court, on its own motion or on the request of a party in interest –

(1) shall hold such status conferences as are necessary to further the expeditious and economical resolution of the case; and

(2) unless inconsistent with another provision of this title or with applicable Federal Rules of Bankruptcy Procedure, issue an order at any such conference prescribing such limitations and conditions as the court deems appropriate to ensure that the case is handled expeditiously and economically, including an order that –

(A) sets ~~the~~ date by which the trustee must assume or reject an executory contract or unexpired lease; or

(B) in a case under chapter 11 of this title –

(i) sets a date by which the debtor, or trustee if one has been appointed, shall file a disclosure statement and plan;

(ii) sets a date by which the debtor, or trustee if one has been appointed, shall solicit acceptances of a plan;

(iii) sets the date by which a party in interest other than a debtor may file a plan;

(iv) sets a date by which a proponent of a plan, other than the debtor, shall solicit acceptances of such plan;

(v) fixes the scope and format of the notice to be provided regarding the hearing on approval of the disclosure statement; or

(vi) provides that the hearing on approval of the disclosure statement may be combined with the hearing on confirmation of the plan.

Section 1123 of the Bankruptcy Code, 11 U.S.C. § 1123, provides:

**§ 1123. Contents of Plan.**

(a) Notwithstanding any otherwise applicable nonbankruptcy law, a plan shall –

(1) designate, subject to section 1122 of this title, classes of claims, other than claims of a kind specified in section 507(a)(2), 507(a)(3), or 507(a)(8) of this title, and classes of interests;

(2) specify any class of claims or interests that is not impaired under the plan;

(3) specify the treatment of any class of claims or interests that is impaired under the plan;

(4) provide the same treatment for each claim or interest of a particular class, unless the holder of a particular claim or interest agrees to a less favorable treatment of such particular claim or interest;

(5) provide adequate means for the plan's implementation, such as –

(A) retention by the debtor of all or any part of the property of the estate;

(B) transfer of all or any part of the property of the estate to one or more entities, whether organized before or after the confirmation of such plan;

(C) merger or consolidation of the debtor with one or more persons;

(D) sale of all or any part of the property of the estate, either subject to or free of any lien, or the distribution of all or any part of the property of the estate among those having an interest in such property of the estate;

(E) satisfaction or modification of any lien;

(F) cancellation or modification of any indenture or similar instrument;

(G) curing or waiving of any default;

... (H) extension of a maturity date or a change in an interest rate or other term of outstanding securities;

(I) amendment of the debtor's charter; or

(J) issuance of securities of the debtor, or of any entity referred to in subparagraph (B) or (C) of this paragraph, for cash, for property, for existing securities, or in exchange for claims or interests, or for any other appropriate purpose;

(6) provide for the inclusion in the charter of the debtor, if the debtor is a corporation, or of any corporation referred to in paragraph (5)(B) or (5)(C) of this subsection, of a provision prohibiting the issuance of nonvoting equity securities, and providing, as to the several classes of securities possessing voting power, an appropriate distribution of such power among such classes, including, in the case of any class of equity securities having a preference over another class of equity securities with respect to dividends, adequate provisions for the election of directors representing such preferred class in the event of default in the payment of such dividends;

(7) contain only provisions that are consistent with the interests of creditors and equity security holders and with public policy with respect to the manner of selection of any officer, director, or trustee under the plan and any successor to such officer, director, or trustee; and

(8) in a case in which the debtor is an individual, provide for the payment to creditors under the plan of all or such portion of earnings from personal services performed by the debtor after the commencement of the case or other future income of the debtor as is necessary for the execution of the plan.

(b) Subject to subsection (a) of this section, a plan may –

(1) impair or leave unimpaired any class of claims, secured or unsecured, or of interests;

(2) subject to section 365 of this title, provide for the assumption, rejection, or assignment of any executory con-

tract or unexpired lease of the debtor not previously rejected under such section;

(3) provide for –

(A) the settlement or adjustment of any claim or interest belonging to the debtor or to the estate; or

(B) the retention and enforcement by the debtor, by the trustee, or by a representative of the estate appointed for such purpose, of any such claim or interest;

(4) provide for the sale of all or substantially all of the property of the estate, and the distribution of the proceeds of such sale among holders of claims or interests;

(5) modify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtor's principal residence, or of holders of unsecured claims, or leave unaffected the rights of holders of any class of claims; and

(6) include any other appropriate provision not inconsistent with the applicable provisions of this title.

(c) In a case concerning an individual, a plan proposed by an entity other than the debtor may not provide for the use, sale, or lease of property exempted under section 522 of this title, unless the debtor consents to such use, sale, or lease.

(d) Notwithstanding subsection (a) of this section and sections 506(b), 1129(a)(7), and 1129(b) of this title, if it is proposed in a plan to cure a default the amount necessary to cure the default shall be determined in accordance with the underlying agreement and applicable nonbankruptcy law.

**Supreme Court of the United States  
Office of the Clerk  
Washington, DC 20543-0001**

**William K. Suter**  
Clerk of the Court  
(202) 479-3011

December 20, 2005

Mr. John B. Berringer  
Anderson Kill & Olick, P.C.  
1251 Avenue of the Americas  
New York, NY 10020

Re: Official Representatives of the Bondholders and  
Trade Creditors of Debtors Owens Corning, et al.  
v. Credit Suisse First Boston, as Agent for the  
Prepetition Bank Lenders, et al.  
Application No. 05A558

Dear Mr. Berringer:

The application for an extension of time within which to  
file a petition for a writ of certiorari in the above-entitled case  
has been presented to Justice Souter, who on December 20,  
2005 extended the time to and including January 26, 2006.

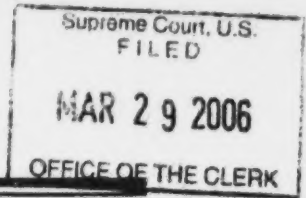
This letter has been sent to those designated on the attached  
notification list.

Sincerely,

**William K. Suter**, Clerk  
by /s/ RUTH JONES  
Ruth Jones  
Case Analyst

[attached notification list omitted]

(4)  
(3)  
Nos. 05-827, 05-941



**In the Supreme Court of the United States**

JAMES J. McMONAGLE,  
THE LEGAL REPRESENTATIVE FOR FUTURE CLAIMANTS,  
v. *Petitioner,*  
CREDIT SUISSE FIRST BOSTON, AS AGENT, *ET AL.,*  
*Respondents.*

OFFICIAL REPRESENTATIVES OF THE BONDHOLDERS AND  
TRADE CREDITORS OF DEBTORS OWENS CORNING, *ET AL.,*  
v. *Petitioners,*  
CREDIT SUISSE FIRST BOSTON, AS AGENT, *ET AL.,*  
*Respondents.*

**On Petitions for a Writ of Certiorari to the United States  
Court of Appeals for the Third Circuit**

**BRIEF FOR RESPONDENT  
CREDIT SUISSE FIRST BOSTON, AS AGENT,  
IN OPPOSITION**

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*Counsel for Respondent Credit Suisse First Boston, as Agent*

*\* Counsel of Record*

## QUESTION PRESENTED

Whether, under any valid application of the judicially developed bankruptcy doctrine of substantive consolidation, Owens Corning and seventeen of its subsidiaries that admitted having substantially correct financial statements showing each entity's assets and liabilities can propose a valid chapter 11 reorganization plan depriving their bank lenders of the subsidiaries' individual guarantees of \$1.6 billion of bank loans, by "deeming," as to the banks only, that the subsidiaries would be merged into Owens Corning, thereby overriding the Bankruptcy Code to extinguish the guarantees and reducing the banks' aggregate bankruptcy principal distributions from \$1.6 billion to \$600 million.

**PARTIES TO THE PROCEEDINGS  
AND RULE 29.6 STATEMENT**

This matter arises out of a motion filed in bankruptcy court. The movants were petitioner James J. McMonagle; the Official Committee of Asbestos Claimants; and debtors Owens Corning *et al.*, more fully identified in 05-827 Pet. iii n.1. The motion was also supported by petitioners Official Representatives of the Bondholders and Trade Creditors of Debtors Owens Corning, the membership of which is identified in 05-941 Pet. ii and iii. The opponent of the motion was respondent Credit Suisse First Boston, as Agent for the prepetition bank lenders. Although the motion was filed in the first instance in the bankruptcy court, it was not decided in that court, but rather was decided in the first instance by the district court. *See* 05-827 Pet. App. 8 n.8. On appeal to the Third Circuit, the appellant was respondent Credit Suisse First Boston, as Agent for the prepetition bank lenders, and the appellees were the movants and motion supporters identified above. The listing of parties in 05-827 Pet. iii is accurate except to the extent it refers to appellees as “defendants/appellees” and appellant as “plaintiff/appellant.”

In this Court, McMonagle and the Official Representatives of the Bondholders and Trade Creditors of Debtors Owens Corning are petitioners; the Official Committee of Asbestos Claimants is a respondent under Rule 12.6 and has filed a brief in this Court as a respondent supporting petitioners; and debtors Owens Corning *et al.* are respondents under Rule 12.6.

Respondent is Credit Suisse, Cayman Islands Branch, formerly known as Credit Suisse First Boston. It is a branch of Credit Suisse, which is a wholly owned subsidiary of Credit Suisse Group, the shares of which are publicly traded on the Swiss Stock Exchange. No publicly held corporation owns 10% or more of the stock of Credit Suisse Group.

Credit Suisse, Cayman Islands Branch, is Agent for a syndicate of lenders to Owens Corning. The current members of that syndicate include Bear Stearns & Co. Inc. and UBS AG, both of which have issued publicly traded common stock. The

current members of the lending syndicate also include Credit Suisse, Cayman Islands Branch, Bank of America, N.A., Citibank, N.A., Citigroup Financial Products, Inc., Deutsche Bankers Trust Co., Goldman Sachs Credit Partners, L.P., JP Morgan Chase Bank, Lehman Commercial Paper, Merrill Lynch Credit Products, and Morgan Stanley Emerging Markets, whose parent entities have issued publicly traded common stock. Those parent entities are Credit Suisse Group, Bank of America Corp., Citigroup, Inc., Deutsche Bank Group, Goldman Sachs Group, Inc., JPMorgan Chase & Co., Lehman Brothers, Inc., Merrill Lynch & Co., Inc., and Morgan Stanley, respectively. Credit Suisse, Cayman Islands Branch, is not aware of any other current members of the lending syndicate that have issued, or are subsidiaries of entities that have issued, publicly traded equity and does not maintain or have ready access to such information.

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**BRIEF FOR RESPONDENT  
CREDIT SUISSE FIRST BOSTON, AS AGENT,  
IN OPPOSITION**

Nonconsensual substantive consolidation is an extraordinary remedy, devised by judges – despite the absence of any specific statutory authorization for disregard of the corporate form in this manner – to deal with extreme situations in bankruptcy cases. Rather than compute how much each debtor-entity owes each of its creditors, the remedy treats separate corporations as if they were merged, thereby treating all creditors as if they were creditors of one combined entity. Here, Owens Corning attempted to radicalize this extraordinary remedy in three respects. First, it requested substantive consolidation only on a “deemed” (make-believe) basis, thereby leaving the corporate structure unchanged after bankruptcy while computing distributions to Owens Corning’s bank lenders as if the subsidiaries had been merged into Owens Corning so the banks would lose the benefits of the guarantees they received from twelve of the subsidiaries. Second, Owens Corning specified this make-believe substantive consolidation would be used only to compute (and thereby diminish) the banks’ distributions and not to compute any other creditor’s distribution from any of the subsidiaries. Third, Owens Corning requested this relief while admitting its financial statements substantially correctly specified that each entity’s assets and liabilities and that the banks required the guarantees when they committed to making the loan.

No decision from any court of appeals has ever granted such radical relief in similar circumstances. Moreover, no decision of any court of appeals has ever granted a less radicalized substantive consolidation when its proponents admitted that each entity’s assets and liabilities were known and the objecting creditor had shown its recognition of separate entities by requiring separate guarantees. This case provided the Third Circuit an opportunity to state comprehensively its view of the substantive consolidation doctrine, including its view of the

hazards of following or misconstruing stray language in opinions of other courts. *See* 05-827 Pet. App. 23-27. To reject Owens Corning's proposed substantive consolidation, however, the court did not need to place itself in conflict with any other court besides the district court it was reversing. Rather, as bankruptcy professors Robert K. Rasmussen, Barry Adler, Susan Block-Lieb, G. Marcus Cole, Marcel Kahan, Ronald J. Mann, and David A. Skeel, Jr., advised the Third Circuit in an amicus brief filed December 29, 2004 (at 1), "no appellate court to date has confronted a situation similar to the one presented in this case." *See also* 05-827 Pet. App. 24-25 & n.17 (agreeing with other aspects of professors' brief).

Significantly, every court of appeals cites with approval the decisions from the Second Circuit ruling that substantive consolidation is granted sparingly and only where necessary to remedy harm caused by fraud, hopeless commingling of assets, or an expectation by all creditors that they were dealing with one entity. None of those factors exists here. Some courts of appeals are more specific than others as to exactly which harms or benefits justify substantive consolidation. But the case at bar is not on the fringes. It comes nowhere close to satisfying any circuit's requirements.

There is no conflict among the courts of appeals with respect to the "easy" issue decided by the Third Circuit. 05-827 Pet. App. 2. Finally, petitioners' assertion that the Third Circuit inappropriately disregarded the district court's findings of fact is untrue. The district court wrote a seven-page decision of which a few scattered sentences purport to sum up more than 10,000 pages of trial record. As the Third Circuit showed, the district court simply did not account for the undisputed individual facts relating to the different subsidiaries.

## **STATEMENT**

### **A. Relevant Facts**

1. Owens Corning's Operations and Corporate Structure. Owens Corning is a Fortune 200 multinational company with an elaborate and carefully maintained corporate structure. Each

subsidiary of Owens Corning, the parent Delaware corporation ("OCD") was a separate legal entity that scrupulously observed corporate formalities<sup>1</sup> and had a legitimate reason to exist separately. The subsidiaries were formed for a variety of business and strategic objectives. Some subsidiaries were free-standing, operational companies in their own right; some subsidiaries were formed to limit asbestos-related liability concerns; some were formed to gain tax and other business benefits; and others were formed for regulatory reasons. The financial affairs of each subsidiary were properly documented.<sup>2</sup> Each subsidiary maintained its own business records, and intercompany transactions were regularly documented. While OCD, as the parent corporation, owns all the stock of its subsidiaries and operated its enterprise in an integrated manner, the legal structure of its subsidiary corporations was respected at all times.

Examples of the major subsidiaries are as follows: Integrex was a freestanding entrepreneurial company designed to market litigation management, materials testing, and other services to third parties. CA App. 601-02, 760, 824-28, 831-32, 5421, 5423, 5426, 5427, 5438, 5821, 7813; CA Conf. App. 898: 109a, 239, 239a, 245, 266, 308, 356, 357a, 358, 367-6° 370-71, 380, 413, 426, 430a, 448-57j. Exterior Systems, Inc. ("Exterior") was formed after several subsidiaries of Fibreboard Corporation

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<sup>1</sup> See, e.g., CA Conf. App. 983: 33, 37-38, 39, 41-42, 47-48, 108, 310-11, 316-18, 355-58; CA Conf. App. 1022: 8, 8a, 8b, 9, 10, 13-14, 19-20, 26, 32-46, 50-61, 339; CA Conf. App. 898: 1, 1K, 2, 3, 6-10, 20-22, 151, 156, 158, 554, 655, 660, 661, 663-64; CA Conf. App. 830: 5-20, 199-02, 208-12, 225-32, 233, 234, 235-42, 243-45, 250-52, 253-55, 257, 258, 259-60, 261, 263-69, 271-73, 276-85, 286-95, 299, 300-05, 306-08, 311-15, 318, 320-23, 324, 327, 339-54, 355-58, 361.

<sup>2</sup> CA App. 465-67, 692-93, 1303-04, 2954, 2958, 3002, 3004, 3006, 3008, 3010, 3012, 3018, 3029, 3262, 3652, 4579, 5162, 5200, 5310, 6391, 6499, 6612, 6760, 7057, 7126.1, 7823, 7862, 7951, 7959, 8365, 8429, 8523, 8927-37, 9111-13, 9346-50, 9666-9738, 9744, 9953-54, 9959-59.1, 9975-76, 9978, 9979, 10087, 10090-91; CA Conf. App. 898: 137, 139-40, 144-45, 174-75, 330, 541-42, 544; CA Conf. App. 1022: 296, 304-312, 328; CA Conf. App. 983: 52, 81-84, 268, 339-41; CA Conf. App. 830: 363, 379, 395, 412, 427, 434, 437.